Collective Switching and Possible Uses of a Disengaged Consumer Database

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1. Executive Summary

This report analyses collective switching in principle and practice, and examines potential uses of a database of disengaged consumers whose construction was recommended by the 2016 Competition and Markets Authority (CMA) investigation report into the energy market. It first outlines briefly the background to the issue in the GB energy market, in particular on past switching rates, concerns and policies, and considers what is distinctive about a Collective Switch. Collective switching is a form of delegated decision making where the consumer, either consciously or through inactivity, delegates all or part of the switching decision to a third party. Delegated decision schemes in general include: a third party using a Price Comparison Website to switch individuals, a third party offering to monitor and optimise their contracts, or a third party organising a collective switching auction. The scene is set in section 2.

The report assesses collective switching as a solution to consumer inactivity. Section 3 reports information from collective switches and similar schemes, particularly in Britain, Australia and some US States to identify which schemes have performed well and why. We note that there is considerable variation across the different experiences and that some of the designs depend on both the regulatory structure and local democracy. It is also evident that the schemes involve numbers far lower than what one might contemplate in GB if one was to reduce the number of disengaged consumers significantly. In particular, we discuss the typically low engagement rates in opt-in schemes. As a consequence, section 4 discusses the principles of opt-in and opt-out mechanisms, relating both their design and observations from experience to the literature on behavioural economics. In particular, the design of defaults will affect how many and which consumers will engage in such auctions. The key insight is that there is a very substantial difference between opt-in and opt-out mechanisms in terms of likely participation.

Section 5 goes on to discuss the detail of one proposal for utilising a database of disengaged consumers: a reverse auction held to determine the supplier(s) who would provide disengaged consumers with energy. We identify some of the key challenges with designing the auction, which given the number of disengaged households in GB would be unprecedentedly large, as well as some of the advantages and disadvantages. One challenge is the need to divide the set of consumers who are to be part of a collective switching mechanism. The size of the set will depend on whether consumers have to opt in or out and whether they opt in [or out] once, i.e. provide consent to be on a database, be part of an auction and be switched in a single action, or each consent is obtained separately. Having to opt in separately, first to be placed on a database, then to be entered into the collective switch auction, and finally to accept the offer that wins the auction, is likely to reduce the number of participants dramatically. Having defined the blocks, will these be auctioned off sequentially or using a falling clock auction? Moreover, is the auction aiming to deal with the stock of unengaged or the flow of unengaged at infrequent or regular intervals? While an auction mechanism will have advantages in terms of creating competitive pressure and hence
lower prices, as well as saving search and switching costs for consumers, it also has costs. These costs include those of designing and running the auction, of switching large numbers of consumers, including costs from any errors which may arise, and the likely external effect on consumers who are currently active. Evaluating the success of such a policy intervention is hard both ex-ante and ex-post, partly because we do not have any benchmark and partly because we cannot assume that consumer behaviour and firm behaviour are unaffected by the introduction of the mechanism. Section 6 presents conclusions on the potential of collective switching to address consumer disengagement.

There are two appendices to the report. Appendix A presents in note form ‘blue sky thinking’ on some other ways to use a database of the disengaged, in all cases assuming no legal complications. In the spirit of thinking creatively, options considered include those which the authors expect to face significant technical, legal and/or political obstacles. Appendix B addresses legal issues of data privacy, emphasising possible uncertainty around the construction and use of a disengaged consumer database. The uncertainty posed by Brexit and the commercial implications of the status of Britain vis à vis the EU further complicate the legal picture; at the same time the privacy lobby may limit what is practicable at a time when anxieties about new arrangements are likely to be heightened.

The overall conclusion is that the options for the use of a disengaged database that effectively address the problems identified by the CMA are likely to be challenging to implement both technically, and often legally, while in all cases the eventual outcome is uncertain. The task of either activating or protecting the large number of households likely to find themselves on a database is considerable and requires extensive planning and testing. However, if these challenges can be overcome, collective auctions could provide a way of delivering the benefits of the competition to consumers who are currently disengaged from the market.
2. Introduction

The retail energy market for residential and small business users in Great Britain was opened between 1996 and 1999, and the final retail price caps were removed in 2002. While there were many new entrants as the market opened, most of these exited through takeover or bankruptcy, so that by the mid noughties the main competitors were the survivors of the original incumbent suppliers in each of the fourteen electricity regions (by then consolidated into five large companies) and the previous gas incumbent, British (in Scotland, Scottish) Gas. While many saw the early stages of retail residential competition as successful, as real energy bills continued their previous falling trend, the years after the consolidation of the companies in 2003 were characterised by increasing real energy bills. As prices rose, concern about the behaviour of these six large suppliers grew, leading to Ofgem’s 2008 Energy Supply Probe, and the imposition of regional non-discrimination clauses the following year, though these were discontinued after their initial three year period. A further review of the retail market to assess the effects of the Probe’s remedies found a large expansion in the number of tariffs being offered, and a fall in switching rates after 2008, except at times of political salience following political announcements (from both the prime minister and the leader of the opposition) about the market. These concerns were reflected in Ofgem’s 2012 Retail Market Review and restrictions were imposed from 2013 on the number of tariffs which companies could offer. With continuing public concern about how well the market was functioning, Ofgem undertook a further review of the market and referred it to the CMA in June 2014 for a full investigation, identifying low consumer engagement as a potential problem. This investigation reported in June 2016, and, among other outcomes, found that Weak Consumer Response was a Market Feature with an Adverse Effect on Competition. A number of remedies were proposed for this and the other problems identified. The most relevant for this paper are the orders for gas and electricity suppliers to provide specified details of their consumers who had been on one of their standard variable tariffs (SVTs, or default tariffs) for three years or more (a Disengaged Consumer Database); and recommendations to Ofgem that, subject to certain safeguards, such a database should be made available to rival suppliers so that they could use it for marketing their own offers. Potential use of such a database, including for opt-out collective switching schemes, forms the subject of this report.
3. Existing Evidence on Collective Switches

This section first defines what we mean by collective switching and provide high level examples of these before going on to summarise the existing evidence.

3.1 The Essence of Collective Switching Mechanisms

Collective switching is a mechanism which offers bespoke deals to a group of previously identified consumers. While the simplest form of a collective switching mechanism offers each member of the group the same single offer on either an opt-in or an opt-out basis, there are examples, as illustrated in section 3.1.3 below, where some members of the group get offered more than one deal to choose between.1

Collective switching mechanisms belong to a set of solutions which allow consumers fully or partially to delegate the searching, switching and possibly monitoring processes to a third party intermediary. Examples of these, described in more detail below, are:

- Collective switching through an arranged auction with suppliers invited to tender
- Collective switching through bargaining/negotiation with specific suppliers
- Individual switching through a price comparison website offering monitoring services2
- Individual switching through third party brokers who continually monitor available offers3

One obvious transaction cost advantage of the collective switch process is shared with Price Comparison Websites (PCWs): a consumer needs to provide their energy and personal details only once to explore better energy deals for their particular circumstances. In this way, collective switches offer a reduction in search costs. These solutions may reduce transactions costs for consumers but create a new layer between retailer and consumer with its own associated costs, covered either through a fee from the consumer or the retailer.4

Below we summarise the salient features of these mechanisms, focusing on collective switching and what makes them different.

3.1.1 What makes a collective switch distinctive?

Before discussing the evidence on collective switches and possible proposals for a disengaged consumers database we first identify the core element of collective switches that distinguishes them and which elements of collective switches might be considered ‘add ons’ or variations. The core of true collective switches is the aggregation of a large number of consumers into a block offered to suppliers in the hope that the buyer power associated with buying in bulk will deliver a lower price. We also suggest that true collective switches involve a dedicated auction process where firms bid to

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1 In such cases, the number of alternative deals is small, typically just two.
2 An example is MoneySavingExpert’s Cheap Energy Club which appears to offer a personalised PCW service with the option for ongoing reminders when cheaper deals become available. (For more information, see https://clubs.moneysavingexpert.com/cheapenergyclub/register).
3 An example of this is Flipper (see https://flipper.community/#123). For an annual fee of £25, Flipper offers a quarterly market monitoring service on an ongoing basis (it appears to be a PCW with improved estimation algorithms) combined with an automated switching facility.
4 Where the intermediary segment ends up concentrated, this may inflate fees beyond the direct costs of offering the service.
supply the block of consumers for the lowest price.\textsuperscript{5} If the exercise fails to produce deals that were previously unavailable to at least some participants, then the collective switch is not delivering its distinctive economic purpose, namely to achieve and exploit buyer power. However collective switches which do not achieve buyer power can still offer demonstrable benefits by encouraging switching and enabling consumer savings, but in this case the term ‘collective switch’ is really only being used to describe a particular form of marketing strategy. While in an ideal world the buyer power resulting from aggregation would result in firms developing bespoke deals to win the collective switch auction, it is unclear how frequently this occurs (at least in GB); instead the ‘auction’ may offer little more than the opportunities provided by a price comparison service.

In terms of the advantages for firms, Bates (2012) emphasises that collective switches offer a potentially low-cost consumer acquisition tool that can provide a step-change in market share. As DECC (2013) reports, while collective switches may enable smaller energy firms to expand rapidly these firms also have a limited capacity to digest large volumes of new customers. For example, DECC (2013) notes that while Which?’s The Big Switch (TBS) enabled the winning firm, Co-operative Energy (Co-Op), to double its customer base overnight, Co-Op also capped the number of new customers it would accept at 30,000. DECC (2013) claims that the larger collective switch auctions in GB have tended to be won by large energy firms. Bates (2012) also suggests that collective switches offer efficiency savings in terms of reduced marketing costs, although, from the perspective of firms, these savings may be offset by the need to offer a particular low price to win in a collective switch’s auction. Assessing the frequency with which energy suppliers have offered bespoke tariffs for processes labelled ‘collective switches’ would provide an initial guide to the attractiveness of collective switches to firms. Firms who bid their standard fixed term tariff into collective switch auctions seem to reveal little information about the appeal of these mechanisms to firms since this bidding behaviour represents a zero cost option to firms.

\subsection*{3.1.2 Auctions involving ‘Default Retailers/Services’}

Since the distinctive features of collective switches are the aggregation of consumers and an auction process, they bear some similarity in economic terms to the provision of a ‘default supplier’ in an energy market which procures supplies through an auction process such as the Italian ‘Single Buyer’ and the municipal aggregation framework in the US. These mechanisms focus on the wholesale part of the total energy bill. From the literature it is difficult to be sure how the remaining retail/distribution component of energy bills is determined. Without regulation of the retail component of the bill one might be concerned that any wholesale savings achieved through the auction may not be fully passed through to consumers.\textsuperscript{6}

The similarity to an ‘opt-out’ auction arises because, if a consumer does nothing they remain with the ‘default retailer’, with the wholesale component of their electricity supply determined by an auction process. All consumers who do not make the positive step of switching to a competitive energy retailer (i.e. who opt out of the default supply/opt in to the competitive section of the market) continue to receive a supply from the default retailer.

\textsuperscript{5} While there are examples which only involve direct bargaining with one supplier, see sections 3.1.3 and 3.1.4, we focus on the use of procurement auctions to elicit offers. Sectors, such as energy, where a homogeneous commodity is being purchased are well-suited to such an approach.

\textsuperscript{6} DECC (2014) notes that in GB any collective purchasing scheme seeking to engage with the wholesale energy market for the purposes of energy supply would either need to become a licensed energy supplier or seek an exemption from this licensing requirement.
Italy: The organisation running the framework in Italy is Acquirente Unico (AU) and while it is commonly referred to as a 'Single Buyer' both Arizu et al (2006) and Castalia Strategic Advisors (2013) indicate that this term is a misnomer. Arizu et al and Castalia Strategic Advisors both explain that the term Single Buyer properly refers to a particular structure for organising the energy wholesale market, and they argue AU is more akin to a 'default retailer' i.e. an entity that engages in the wholesale market to procure supplies for consumers who are not taking advantage of offers provided by alternative competitive retailers.

AU has evolved gradually, reflecting the process of liberalisation in the Italian electricity market. Between 2004 and 2007 the Italian retail electricity market was split into two segments: ‘eligible’ customers who had a competitive retail supply and a ‘captive’ market of household consumers. For this period AU operated as the regulated monopolist for the ‘captive’ segment with the price charged by AU being equal to AU’s average purchasing cost. Since July 2007 (as required by EU regulations) all household energy consumers have had access to competitive retailers, with AU acting as a default supplier akin to a wholesaler offering an ‘enhanced protection service’ to households and SMEs, with prices set at AU’s average purchasing cost. Whether consumers have to opt in to the ‘enhanced protection service’ or are in the ‘enhanced protection service’ by default and have to opt out to take part in the competitive section of the market is currently unclear. There were 27 million protected consumers in 2013 consuming 64 TWh of electricity (compared with 28 million and 70TWh in 2012).

The presentation also notes that the average retail price was lower for protected households than for households engaging with the free market in both 2012 and 2013 (€108.41 per MWh vs €114.97 per MWh in 2012 and €103.74 per MWh vs €121.03 per MWh in 2012). Despite this apparently favourable performance the future of AU has been challenged as its existence appears in tension with EU requirements for a fully liberalised retail energy market. Salant (2003) argues strongly in favour of entities such as AU when a large group of consumers do not actively engage with the retail energy market.

New Jersey: In the US a framework in New Jersey to ensure competitively priced energy for unengaged consumers is described by Arizu et al (2006) and Salant and Loxley (2004). In New Jersey there is full retail competition, as all retail customers have the right to choose their supplier, but apparently very few energy customers have exercised this right. Four companies distribute power and in the first three years following the introduction of retail competition they remained the default service providers (labelled ‘basic generation service’) to households who did not switch; each charged ‘pre-set’ prices in this period. In the third year New Jersey law required that the energy for the default service was procured through a competitive auction overseen by the New Jersey regulator (Regulatory Commission). The regulator hired the economic consultancy NERA to design and implement the

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7 See the presentation ‘From single buyer to the default supplier: The Italian experience’ by a member of the Autorita per l’energia elettrica il gas e il sistema idrico in Ljublana, 1 October 2014, available at: https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3396150/0633975ADCF7B9CE053C92FA8C06338.PDF
8 One presumes that in reality the price also included an element reflecting distribution costs.
9 The definition of SMEs is firms with fewer than 50 employees and sales below €10m.
10 The presentation ‘From single buyer to the default supplier: The Italian experience’ (see fn 8) implies the former, but past informal conversations between AU representatives and members of the research team seemed to imply it was the latter.
11 See slide 19 of ‘From single buyer to the default supplier: The Italian experience’ (see fn 8).
12 The presentation indicates that the average electricity price for protected SMEs was below that for SMEs engaging in the competitive market in 2012, but by 2013 this situation had reversed. The source for this pricing data is stated as “AEEGSI Annual Report”.
13 This paper focuses specifically on the selection of the auction design used in the New Jersey setting.
auction, with the cost of NERA’s services being charged to the distribution companies (and so eventually recovered from consumers).

Arizu et al (2006) report that the auction in February 2003 attracted 20 bidders to supply capacity and energy worth $5.2bn. The auction was held over the Internet and took the form of a descending ‘clock’ auction involving multiple bidding rounds with the price ticking down until the quantity of energy being offered fell to a level matching the quantity being sought. The bidding covered tranches, each representing a uniform bundle of 2% of the residential, commercial and industrial loads of each of the four distribution companies. There were separate auctions for residential and industrial users and the winning bidders committing to supply energy for one year, with around a third of the default service load being auctioned each year.

Arizu et al (2006) describe a structure that appears to be a ‘hybrid’ switching arrangement where consumers do not have to switch away from their existing local supplier (distribution company) but the local distributors never own the energy procured through the auction, with them simply acting as agents for the retail consumers. The risk that demand is higher or lower than predicted is borne by the bidding suppliers while the risk that consumers do not pay is borne by the distribution companies. Salant and Loxley (2004) emphasise that in this framework the distribution companies remained responsible for billing and for energy losses through the distribution network. The former point is significant for the use of a disengaged consumer database since it means that in the New Jersey setting the significant operational challenges of transferring the contractual relationship between consumers and retailers en masse is avoided. In the current GB setting avoiding this substantial organisational challenge appears more difficult. Arizu et al (2006) report that the distribution companies add a “distribution margin” to the winning bids for the generation service. One presumes that this distribution margin is, at least partially, regulated since it must cover the natural monopoly grid. Also, the vertically integrated incumbent distribution companies are allowed to bid in the auction for the right to provide a wholesale supply to the customers within their traditional area.

This auction process appears to have been a stable institutional framework with the website representing the auction process, www.bgs-auction.com, stating that the auctions for 2017 are due shortly. The website makes clear that bidders in the auction are required to provide a “full requirements service” to the default service consumers, “including capacity, energy, ancillary services, transmission and any other service as required by PJM” (the regional grid controller), which is apparently different from the arrangement described in Arizu et al (2006). Suppliers assume any migration risk and must also satisfy the state’s renewable portfolio standards. The website also states that residential consumers “pay rates derived from the auction clearing prices and these rates vary by season and in some cases by time of day”.

3.1.3 Other Group Buying Approaches

Another business model which appears similar to collective switching, but which has its own distinctive elements, are group buying platforms such as Groupon. As explained by Bates (2012), these platforms do not use the distinctive auction model of collective switches, but rather negotiate a deal in advance of a marketing campaign with the deal typically only being honoured if sufficient consumers express a willingness to purchase at the discounted price. Group buying platforms also tend to restrict

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14 This point is directly contradicted by Salant (2003).
15 See http://www.bgs-auction.com/default.asp
16 The quotes in this paragraph are taken from: http://www.bgs-auction.com/bgs.auction.overview.asp
the deals they offer to specific geographical locations with tight time limits to encourage engagement and promotion through peer networks.

The running of an explicit auction process also makes collective switches distinctive from general consumer boycotts and campaigns for consumers to switch suppliers. For example, Bates (2012) highlights the case of ‘Bank Transfer Day’ in the US, a campaign to encourage consumers to switch from commercial banks to not-for-profit credit unions before 5 November 2011. This movement centred on social media and appears to have emerged following Bank of America imposing a $5 monthly fee for using their debit card. Rather than bringing consumers together to use their buyer power to negotiate a specific discounted deal, campaigns such as this focus on withdrawing demand from a particular company (or set of companies) when the company(ies) perform an action which is disliked.

3.1.4 The One Big Switch approach

A model detailed by Bates (2012) that appears to combine the consumer campaign and group buying/collective switch model is that run in the summer of 2011 by Choice, an Australian consumer body, and One Big Switch a profit-making Australian group switching/buying platform. This initial switching scheme aimed to obtain improved mortgage deals for participants and appears to have used a model that is somewhere between those of a group buying platform and a collective switch. Like a collective switch, a campaign is run to recruit consumers into an aggregated block to achieve buying power, but like a group buying platform deals are ‘negotiated’ for consumers rather than subject to an explicit auction mechanism. One Big Switch’s UK website states: “One Big Switch specialises in price creation, not price comparison. We use the bargaining power of our members to source discounts on electricity and gas that you cannot get as an individual consumer.”

Bates (2012) reports that 40,000 mortgage holders signed up to the 2011 initiative and five smaller Australian banks provided offers, including one market leading offer, but the four largest Australian banks did not respond. While this scheme attracted a reasonable number of participants, the switching rate was low (at best 5%) with 2,000 individuals entering into ‘detailed discussions’ with banks according to Bates. Bates suggests that the low switching rate may, in part, be explained by consumers being left to initiate and manage their own switch to a new mortgage provider rather than this being handled directly by One Big Switch.

Since this initial scheme One Big Switch has run a series of further campaigns in Australia for energy, insurance and health insurance. The One Big Switch website provides a timeline of these schemes and archived material on each of them. Table 1 below summarises these campaigns.

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17 Additional detail is available at: https://en.wikipedia.org/wiki/Bank_Transfer_Day
18 See https://www.choice.com.au/newhome
19 See https://www.onebigswitch.com.au/?focus=1
20 See paragraph under the heading ‘How is One Big Switch different from electricity price comparison websites’ at: https://www.onebigswitch.co.uk/faq
Table 1 – Australian group buying campaigns organised by One Big Switch

<table>
<thead>
<tr>
<th>Scheme Name</th>
<th>Date</th>
<th>Number of registered consumers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Choice Big Bank Switch</td>
<td>August 2011</td>
<td>40,000</td>
</tr>
<tr>
<td>The Big Electricity Switch</td>
<td>June 2012</td>
<td>252,000</td>
</tr>
<tr>
<td>Truth in Banking – Calculate the Rate Gap</td>
<td>October 2012</td>
<td>20,000</td>
</tr>
<tr>
<td>The Big Health Insurance Switch</td>
<td>February 2013</td>
<td>122,946</td>
</tr>
<tr>
<td>The Big QLD Electricity Switch</td>
<td>June 2013</td>
<td>73,955</td>
</tr>
<tr>
<td>The Big Solar Switch</td>
<td>December 2013</td>
<td>34,294</td>
</tr>
<tr>
<td>The Big Insurance Switch</td>
<td>March 2014</td>
<td>81,585</td>
</tr>
<tr>
<td>The Big Petrol Switch</td>
<td>June 2014</td>
<td>134,463</td>
</tr>
<tr>
<td>The Big Cost of Living Switch</td>
<td>November 2014</td>
<td>111,225</td>
</tr>
<tr>
<td>The Big Health Insurance Switch</td>
<td>March 2015</td>
<td>108,311</td>
</tr>
<tr>
<td>The Big Gas Switch</td>
<td>April 2015</td>
<td>20,271</td>
</tr>
<tr>
<td>The Big QLD Energy Switch</td>
<td>June 2015</td>
<td>32,245</td>
</tr>
<tr>
<td>The Big Energy Switch</td>
<td>June 2015</td>
<td>44,850</td>
</tr>
<tr>
<td>The Big Debt Switch</td>
<td>August 2015</td>
<td>73,000</td>
</tr>
<tr>
<td>The Big SA Energy Switch</td>
<td>June 2016</td>
<td>23,844</td>
</tr>
<tr>
<td>The Big Health Insurance Switch</td>
<td>March 2016</td>
<td>117,075</td>
</tr>
</tbody>
</table>

Since One Big Switch provides group buying activities in the Australian financial services sector it is covered by Australian financial services regulations.22

One Big Switch began operating in the Republic of Ireland in 2014 and in the UK and USA in 2015. In GB One Big Switch’s focus is ‘The Big Energy Switch’ which is a Scottish campaign that One Big Switch’s UK homepage states is: “Scotland’s Fastest Growing Cost of Living Club”.23 One Big Switch’s UK homepage also states that “45,667 Households Joined So Far”24. At the global level, One Big Switch reports that it has over 800,000 members and that over 100,000 households have switched their energy provider as a result of its campaigns.25

3.2 Evidence from Great Britain (GB)

In GB there have been a number of collective switching programmes with a variety of group size and outcomes. This section summarises the key insights from these.

3.2.1 Which?’s The Big Switch (TBS)

The earliest use of collective switching in GB we believe was Which?’s TBS which took place in May 2012. This collective switch was marketed to Which?’s existing members as well as to a wider audience by the campaigning organisation 38 Degrees. CCP worked in conjunction with Which? to perform in-depth empirical research based on this collective switch, using data from observation of participants’ acceptance (or not) of the offer and supplemented by two follow-up surveys (Deller et al, 2014). To

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22 One Big Switch is an Australian Financial Services Licence holder, an Australian Credit Licence holder, a registered member of the Credit Ombudsman Service and a registered member of the Financial Ombudsman Service. See https://www.onebigswitch.com.au/about-us
23 See https://www.onebigswitch.co.uk/?gl=1
24 Figure observed at 1:45pm on 8 March 2017.
25 See https://www.onebigswitch.co.uk/about-us
the best of our knowledge all GB collective switches, including TBS, have been conducted on an opt-in basis.

We believe that only one firm, Co-Operative Energy (Co-Op), offered a bespoke tariff for TBS. At the time an issue raised by potential participants as a potential deterrent to bespoke tariffs in GB collective switches was uncertainty regarding how such a tariff would fit with licence conditions requiring supply to all customers and prohibitions regarding ‘undue discrimination’. Subsequently there was a question as to whether a bespoke collective switch tariff would be counted towards the four tariff cap imposed in the RMR rules, though this is now less relevant with the removal of the tariff cap.

TBS had a number of distinctive features. Firstly, Which? members form a particularly active and informed segment of consumers, and are likely to be closer to ‘active’ members of the energy market than households on a disengaged consumer database. TBS outcomes might therefore be considered as upper bounds on engagement levels in collective switches. Moreover, unlike the consumers on a disengaged consumers database, TBS participants had to provide their consumption and personal data manually, i.e. to make a dedicated effort to take part in the process, so they are likely to be more committed to the process than consumers on a disengaged consumer database.

Secondly, Which? required the winning bidder to offer a single ‘national’ offer (perhaps on grounds of apparent fairness), a condition met by the winning Co-Op offer. Since most suppliers varied prices regionally (to reflect differences in upstream transmission and distribution costs), such geographic uniformity resulted in deals cheaper than Co-Op’s winning bid being available on the market for some consumers in some regions. Such consumers received an email after the auction which presented two offers: the winning auction offer of the Co-Op and the cheapest deal offered by any firm. Among all TBS participants analysed in Deller et al, 47% were shown two offers. In this way Which? offered a combination of a collective switch auction and a PCW comparison through its own commercial energy PCW service.

For the present discussion, the most important finding of Deller el al’s analysis, is that even among a group of motivated consumers who had committed considerable time up front to enter the auction, and were faced with a minimum of additional effort to complete a switch once they received an offer, switching was surprisingly low. Among all the participants who provided complete data (around 147,000 consumers) the switching rate was 24%, while among those consumers who went to the additional effort of completing each of the two CCP surveys (15,000 and 11,000 consumers respectively) the switching rate was 33%. Similarly, Deller et al report that only around a third of the total savings available to the participants were actually captured by switching through the auction. Some did not switch because the TBS offered no savings compared to their existing deal: of all the participants with complete data around 16% were not offered a saving. The rate of switching

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26 Ofgem sent a letter to supply licence holders dated 20 April 2012 in an attempt to address these points.
27 DECC (2014) later made clear that bespoke collective switch tariffs did not count towards the tariff cap as long as: (i) the collective switch was not organised by a licensed supplier or affiliate; (ii) schemes were transparent with well-publicised participation rules; and (iii) the schemes were open to participation by any supplier.
28 Those consumers shown two offers were found to have a lower probability of switching than those shown only one offer.
29 See Table 1, page 9, Deller et al (2014).
30 See http://switch.which.co.uk/
31 See Table 1, page 9, Deller et al (2014). That the survey respondents reported a higher switching rate is unsurprising as the willingness to take part in a survey is likely to indicate a greater commitment to TBS and individual characteristics that inherently support ‘engagement’.
(unsurprisingly) had a statistically significant positive relationship with the size of saving offered, as illustrated in Chart 1.

![Switching rates by size of savings (£)](chart)

**Chart 1: Switching rates for all participants (with complete data) in 'The Big Switch' broken down by saving amount**

Even when savings were significant, i.e. around £300, the recorded switching rate was still only around 40%. Overall, the median saving offered to TBS participants was £120.33

The second of CCP’s surveys was conducted after the end of the Co-Op’s winning fixed term tariff. The data from this second survey provides initial information on how people behave over ‘the medium term’ following a collective switch. Table 2 shows whether respondents were aware that their TBS deal had ended.

<table>
<thead>
<tr>
<th>Knowledge</th>
<th>'Yes'</th>
<th>'No'</th>
<th>'I don't know'</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Received communication about the end of my Big Switch deal</td>
<td>58.5</td>
<td>28.2</td>
<td>13.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Aware that my Big Switch deal has ended</td>
<td>65.4</td>
<td>16.2</td>
<td>18.4</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Note: The questions on which this table is based were only asked to those respondents who switched at TBS. The sample size is therefore 3,571 respondents. The TBS deal had ended several months previously.

**Table 2: Respondents’ awareness of the end of their TBS deal (%)**

Even among the active group who participated and switched in TBS and responded to CCP’s survey, one third were not aware that their deal had ended, indicating that participation did not ensure basic

32 We were unable to record switches that resulted from TBS triggering a consumer to conduct their own search of the market and to switch outside TBS systems.

33 See Table 1, page 9, Deller et al (2014).
knowledge regarding the financial terms of their energy supply in the medium term. A similar message is conveyed by Chart 2 which reports the actions of the sub-sample of respondents in Table 1 who did know their TBS deal had ended.

<table>
<thead>
<tr>
<th>Action</th>
<th>Percentage of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>I accepted the deal offered by my Big Switch energy supplier</td>
<td>55.1%</td>
</tr>
<tr>
<td>My energy supplier offered me another special deal</td>
<td>52.9%</td>
</tr>
<tr>
<td>I looked around for deals from other suppliers</td>
<td>38.3%</td>
</tr>
<tr>
<td>I was automatically switched to another tariff by my Big Switch energy supplier</td>
<td>23.0%</td>
</tr>
<tr>
<td>I switched to an alternative energy supplier</td>
<td>11.3%</td>
</tr>
<tr>
<td>An alternative energy supplier offered me a better deal than my Big Switch energy supplier</td>
<td>8.2%</td>
</tr>
<tr>
<td>I contacted my Big Switch energy supplier and asked for a better deal than the one I was offered</td>
<td>5.4%</td>
</tr>
<tr>
<td>I don't remember</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

Chart 2: (In)action at end of TBS deal among TBS switchers who knew that their TBS deal had come to an end

Among these participants, fewer than 40% of those answering the question looked around for other deals at the end of TBS deal, implying that even among the most aware and active of TBS participants, the majority did not follow the ‘idealised’ action of energy shoppers when their fixed term deal expired. This result appears consistent with a view that TBS did not permanently awaken consumers to energy market engagement, although a robust conclusion on this topic is difficult. Intuitively it seems plausible that a collective switch would provide little persistent boost to energy market engagement, since collective switching events are often marketed as being simpler than individual consumers engaging with the energy market themselves. Chart 2 also illustrates a likely response for a supplier who knows a large block of consumers are coming to the end of a fixed term tariff, as happens following collective switches, to offer a retention tariff to retain as many acquired customers as possible.

3.2.2 DECC’s Cheaper Energy Together fund

Probably the most comprehensive overview of collective switching in GB is provided by DECC (2013) when reviewing the ‘Cheaper Energy Together’ fund that DECC provided to support collective switches between December 2012 and March 2013. The Cheaper Energy Together fund supported 31 projects covering 94 local authorities and 8 ‘third sector organisations’. Overall DECC reports that the collective

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34 Respondents were able to tick multiple activities when answering the question ‘What happened when your Big Switch deal ended?’.

35 This comparative simplicity is only true in comparison to a manual search of energy tariffs, the effort required to take part in existing collective switches appears very similar to that required to use a PCW.

36 The terms of The Big Switch prevented Which? from recontacting those consumers who had switched in the exercise.
switches funded by this scheme “engaged” over 190,000 households and led to 21,000 switches (an aggregate switching rate of 11%). The average saving for those who switched was £131.  

DECC (2013) estimates that 49% of households who registered with Cheaper Energy Together Schemes, and 33% of those who switched, had not switched in the previous three years. Only 7 of the schemes included in their registrations more than 70% who had never switched/not switched for 3 years; the highest rate was 73%, recorded by South Tyneside Council, while the lowest rate was 17% (the Eden Project). These rates of disengagement provide important context for interpreting the switching rates observed and their relevance to an opt-in collective switch utilising a disengaged consumers database where none of those on the database will have switched in the previous three years. The consumers in a disengaged consumer database will, on average, have characteristics that make them less likely to switch than the consumers in the schemes reported by DECC (2013). An additional reason for greater activity levels among participants in the DECC schemes than in a disengaged consumer database, is that individuals needed to spend time and effort providing their contact details and energy consumption information which, itself, demonstrates some engagement. Assuming this information is being automatically transferred to a disengaged consumer database, the population of individuals on the database is likely to be less committed to the process than the self-selected participants in the DECC schemes.

DECC (2013) is frank in reporting that the £5m cost of the Cheaper Energy Together fund was almost double the total consumer savings achieved of £2.7m. In other words, households’ welfare would have been increased by a greater amount if DECC had simply handed out its funding directly to households rather than attempting to encourage switching (though of course knowledge was also obtained from the experiment). However, this poor performance should be put in the context of a delivery timescale which was only 3 months, the approaches taken by fund recipients being deliberately experimental and a focus on engaging vulnerable consumers. The need to finance resource intensive engagement activities to encourage vulnerable consumers to opt in may partially explain the poor performance of the fund.

Engaging vulnerable consumers was often found to require face-to-face contact to fully explain the collective switch model. Other councils found putting leaflets in council tax bill letters was an effective marketing tool. However, DECC (2013) reports some consumers felt disappointed that the actual savings available were lower than those highlighted in earlier marketing material. To maximise the switching rate it was noted that further resource intensive activity after households received their personalised offer appeared helpful, for example the schemes on the Isle of Wight and run by the Centre for Sustainable Energy in Bristol telephoned each participant to talk them through their options.

Annexes A, B and C of DECC (2013) enable a quick analysis of the performance of the schemes funded by Cheaper Energy Together. The switching rates of the schemes varied between 5.5% and 23.1%, with only one scheme recording a switching rate above 20% (the Centre for Sustainable Energy) and 10 schemes recording a switching rate below 10%. In most schemes the proportions who hadn’t switched for three years was about the same amongst participants and switchers. However there were exceptions. In Wiltshire the proportion who hadn’t previously switched was much higher (71%)

37 All savings reported for DECC (2013) are in 2013 prices.
38 The rates of switchers who had not switched for at least 3 years varied from 12% at the Eden Project to 77% at Broadland District Council and South Norfolk Council, with 4 schemes reporting a rate above 70%.
amongst the switchers than among those who signed up to the scheme (49%); while in Blackburn with Darwen the proportions were 69% and 36% respectively.

Comparing the amount of funding per registration and per switch, Birmingham City Council performed worst with £303 of funding being received per registration and £1824 per switch. The most cost effective scheme was Woking Borough Council with £2.34 of funding per registration and £24.93 per switch. 5 schemes achieved a funding per registration of below £10, while 7 achieved a funding per switch of below £100. Most importantly 7 schemes achieved aggregate savings that exceeded the funding they received. If lessons on how to run cost effective opt-in collective switches are sought, further investigation of these schemes may prove useful. While the cost figures above help assess the performance of the schemes funded by Cheaper Energy Together, one should probably be cautious before using them as estimates for the costs of a collective switch utilising a disengaged consumer database given that the latter scheme would be vastly larger involve noticeably very different consumers, as explained above.

DECC (2013) also reports on subsequent collective switches where local authorities attracted consumers into a centralised auction. In June 2013 a collective switch took place aggregating consumers across 63 local authorities which led to 35,000 households registering and 2,000 switching (a switching rate of 5.7%). DECC (2013) also states that in November 2013 another collective switch was planned involving 77 local authorities. When considering the GB collective switching landscape it is important to note that multiple local marketing efforts, possibly with different names, are actually part of the same collective switching auction. For example, DECC (2013) reports that the June 2013 auction involved marketing names including ‘The Big Community Switch’, ‘The Big London Energy Switch’ and ‘Ready to Switch’.

3.2.3 The ‘Big Community Switch’ and iChoosr

It is clear that many schemes marketed as collective switches utilise a distinctive marketing method. As Bates (2012) explains, a third party intermediary is generally at the heart of collective switches, designing and running the auction element and co-ordinating the migration of consumers to new suppliers. Such a third party intermediary finances its operations by receiving commission from suppliers for consumers who switch to their business. The intermediaries that run collective switches in GB are distinct from energy suppliers since they do not purchase energy from the wholesale market, instead they simply direct consumers to the cheapest existing retail supplier. This focus on comparing retail rather than wholesale energy prices distinguishes collective switches in GB from the municipal aggregation schemes that exist in the US.

The central example of a collective switching intermediary in Europe is iChoosr. iChoosr was founded in 2008 and its UK website states that it organises group purchases in 4 countries, has facilitated more than 100 “auctions”, that 1.23 million people have “accepted an offer by iChoosr” and that participants have saved more than £350m in total. Within the UK, iChoosr states that 650,000 households have joined its schemes and that the individuals who switched saved more than £25m with the average saving being £243. Assuming that the £243 average is a mean, this implies that

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39 The next most costly schemes involve funding per registration of £94 (the Eden Project) and funding per switch of £682 (Changeworks).
40 One suspects that this scheme may have been facilitated by iChoosr.
41 Under the heading “Facts and figures about iChoosr” at https://www.ichoosr.co.uk/about-us/, accessed on 7 March 2017
42 Under the heading “iChoosr’s results” at https://www.ichoosr.co.uk/, accessed on 7 March 2017
iChoosr’s activities in the UK have generated around 100,000 switches, with an average switching rate among participants of just under 16%.

In 2014, iChoosr’s website emphasised that a key part of its model was partnering with “reputable community leaders” who recruit the participants for the collective switch through marketing which is in their name but which receives support from iChoosr. As well as providing the community members with cheaper energy, iChoosr’s website in 2014 also made clear that the community leader could expect to receive compensation for their services. In March 2017 the website states: “iChoosr likes to build long-lasting, professional and honest relationships with all stakeholders. We often work with organisations representing the interests of consumers, which we refer to as our ‘community leaders’.” However a statement regarding any payment to these community leaders was not immediately apparent.

A recent example of an iChoosr partnership is the ‘Norfolk Big Switch and Save’ which on its homepage has the logos for the following local authorities: North Norfolk District Council, Breckland District Council, Norwich City Council, the Borough Council of King’s Lynn and West Norfolk, Broadland District Council and South Norfolk Council. While the ‘Frequently Asked Question’ section of the Norfolk Big Switch and Save does include the statement that “iChoosr receives a small commission payment from the supplier who offers the best deal, if you choose to accept the winning bid and switch to the winning supplier”, no further explanation of any commercial relationship between the local authorities and iChoosr could be found. The Norfolk Big Switch and Save appears to be the local branding exercise for a national collective switch run by iChoosr called the ‘big community switch’ which collates participants from a range of local authorities across GB.

The precise relationship between iChoosr and local authorities may be worth exploring further. Although it is not entirely clear whether the following statement is directed at collective switch administrators, like iChoosr, or their marketing partners, DECC’s (2014) guidance to ‘scheme organisers’ states: “It should be clear and transparent to consumers if you are taking commission or fees before they agree to participate in a scheme”.

The partnership of a collective switching intermediary with a trusted organisation bears similarities to affinity marketing where an organisation with a particular constituency markets an offering (generally on favourable terms) of a particular supplier. One potential difference between affinity marketing and collective switching is that in the latter instance the identity of the final supplier is not known to the consumer in advance of the auction. A second possible difference, highlighted by Bates (2012), is that collective switches are often open to individuals beyond a single organisation, as is the case with iChoosr’s ‘big community switch’.

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49 It is interesting to note that Which?, who ran TBS, is both trusted as a consumer representative and is an intermediary since Which? runs its own energy PCW.
50 Suggesting that this statement may include marketing partners, the bullet point immediately above this statement includes the sentence: “When working with a service provider, it is common to share the fee between your organisations”.

15
The ‘big community switch’ website does not identify which firms took part in the auction process and whether any of the tariffs were unique to the auction. Regarding firms’ participation the website states: “In principle any nationwide supplier can participate. The supplier has to meet several pre-determined quality requirements, enabling us to guarantee a smooth, reliable switch for the participants.”\(^{51}\) While hinting at wide participation, the presence of quality requirements may mean that potential involvement is somewhat narrower than all current suppliers. Equally, it does appear essential that a collective switch organiser takes steps to ensure that the winning bidder can provide the promised service and that the mass migration of consumers will occur smoothly. One additional piece of information on the nature of the auction is: “The price offered by the suppliers is independent of the number of participants who make the switch.”\(^{52}\) A recent auction for the ‘big community switch’ occurred on 14 February 2017 with First Utility winning the dual fuel and electricity only online and paper billing contracts. This is a repeated auction with the next auction due to take place on 23rd May.

### 3.2.4 Other Evidence

The CMA’s Energy Market Investigation\(^ {53}\) provides further evidence on collective switching, especially on the engagement of suppliers with these schemes. While the CMA notes that the number of collective switches has grown each year since 2012, they remain a minor part of large and medium sized firms’ acquisition strategies. For example, the CMA reports that for the Big-6 and the next four largest energy suppliers only 2% of their acquisitions came via collective switches. In particular, SSE and Utility Warehouse had not participated in any collective switches.

While the CMA redacted almost all the information in Table 5 of Appendix 9.3 which provides a comparison of suppliers’ SVT bills with the bill resulting from the tariff offered to collective switches, it does provide evidence on the number of collective switches in which each firm has participated, as reported in table 3 below.

#### Table 3: Number of collective switches the CMA records firms as participating in

<table>
<thead>
<tr>
<th>Energy Supplier</th>
<th>Number of collective switches participated in (as recorded by the CMA’s Table 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>E.ON</td>
<td>8</td>
</tr>
<tr>
<td>RWE</td>
<td>1</td>
</tr>
<tr>
<td>British Gas</td>
<td>9</td>
</tr>
<tr>
<td>Scottish Power</td>
<td>12</td>
</tr>
<tr>
<td>First Utility</td>
<td>6</td>
</tr>
<tr>
<td>Co-Op Energy</td>
<td>2</td>
</tr>
<tr>
<td>Ovo Energy</td>
<td>10</td>
</tr>
</tbody>
</table>

The CMA’s own analysis of Table 5 finds that energy suppliers did not offer tariffs cheaper than their SVT prices in all collective switch schemes, but did so in the majority in which they participated.

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\(^{52}\) Second paragraph under the heading “Register for the auction to get a new energy deal” at https://bigcommunityswitch.ichoosr.com/product/customizableinfo.rails?actionId=544&infoTextId=200, accessed on 7 March 2017.

Moreover discounts relative to SVTs were often in the form of credit, gift cards or cashback, rather than in lower energy prices. The only statement regarding the size of the discount to SVT prices was that the highest saving was 24%.

While collective switches remain a marginal part of the GB energy market, it is not surprising that large suppliers respond to them in a lukewarm way: their incentive is to preserve their stock of SVT customers rather than to support a mechanism (collective switching), which, if adopted on a large scale, might seriously erode their own SVT customer base. This means the behaviour of large suppliers regarding existing small scale collective switches may not be a good guide to their behaviour in a collective switch applying to all/a large section of SVT customers.

The CMA provides additional evidence of large firms’ negative attitude to collective switches from submissions received from EDF Energy and First Utility with allegations that collective switches were being artificially encouraged by their exemption from the ‘four tariff rule’. However, the CMA report provides no solid evidence to corroborate these claims. Even if the large firms are not enthusiastic about the mechanism, they may still want to affect its eventual design. For example, the CMA reports that EDF Energy wanted a requirement that all customers should be informed of a firm’s cheapest tariff and that tariffs offered in collective switches should be freely available to all of a supplier’s customers. Such a requirement is likely to reduce the aggressiveness of the prices that firms would bid into collective switching schemes.

### 3.3 The US Experience

In the US, collective switching is generally termed ‘municipal aggregation’ or ‘community choice aggregation’ and their experience predate collective switches in the EU and GB. The earlier adoption of municipal aggregation appears to result from energy regulation occurring at the state level, thus enabling widespread experimentation in the structuring of deregulation and apparently greater awareness than in GB that not all consumers would be enthused by the prospect of engaging with the energy market. That municipal aggregation was potentially seen as an enabler of deregulation can be understood from Littlechild (2008) who reports that when in 1999 Ohio decided to deregulate its electricity market with effect from 2001, it created a municipal aggregator, Northeast Ohio Public Energy Council (NOPEC).

The growth of municipal aggregation appears to have been stimulated by a fundamental lack of competition on the supply side of state energy markets, with the implication that countervailing buyer power was required on the demand side of the market. These differences in institutional setting and market characteristics between the US and the present GB situation limit the relevance of US results to the GB setting. At present in GB there are a very large number of retailers in the energy market, there is no ‘price to beat’ or ‘default service’ and the wholesale energy market is generally thought to be competitive. In particular, as already discussed with respect to New Jersey, US municipal aggregation schemes involve aggregating demand to source supply from alternative generation suppliers rather than from competing retail suppliers. It appears that in these municipal aggregation schemes responsibility for the billing process remains with the incumbent utility, i.e. there is no need to switch consumers’ contractual relationships en masse.

The other major difference with the GB regulatory system and a disengaged consumer database is that adopting opt-out municipal aggregation in the US is conditional on explicit democratic approval, not only in terms of broad laws adopted at state level that allow aggregation in principle, but also at the level of individual local communities to approve the implementation of opt-out aggregation. Such democratic approval and the proceeding public debate are likely to be key to the acceptance of opt-
out structures. Littlechild (2008) notes that in Ohio the democratic approval requires at least two public hearings be held on aggregation before a specific ballot initiative voted on by the local population. Despite the differences in political framework, the US experience may nevertheless provide insights into potential choices in designing opt-out mechanisms.

One key similarity between the US and GB is the encouragement by third party intermediaries of collective switching/demand aggregation. Colton (2006) describes the emergence of municipal aggregation as being “consultant-driven”, arguing that the concept of municipal aggregation is “sold” to authorities.54 As of 2013, Laufer (2013) notes that six states had passed laws authorising municipal aggregation: Massachusetts (1997), Ohio (1999), California (2002), Rhode Island (2002), New Jersey (2003) and Illinois (2009). More recently, New York State passed the required law in 2014 and appears to be trialling the process.55 Since the initiation of municipal aggregation not only requires a state level law to be passed, but voting by each of the local authorities wishing to use municipal aggregation, Colton (2006) notes that the consultants’ work may include helping to prepare the resolutions and public outreach work to ensure electoral approval.

While all the examples described below relate to opt-out municipal aggregation, Littlechild (2008) details the performance of an opt-in aggregation scheme held in Palm Springs, California. This scheme occurred prior to the passing of a law enabling opt-out aggregation in California in 2002, and was initiated in conjunction with Enron, which stipulated that it would supply power only if at least 25% of Palm Spring’s 29,000 residents opted in. While an initial mailing led to 30% of households reporting an ‘interest’ in the scheme, the final sign-up rate, even after television and radio advertising, was only 8.5%. Since this figure was below the 25% participation rate set by Enron the scheme did not proceed.56 Littlechild also reports conversations suggesting that opt-in schemes in other states (Pennsylvania and New Jersey are given as examples) struggle to get participation rates above 5-6%.

### 3.3.1 Ohio

While the references below are now around a decade old, maps provided by the Ohio Public Utilities Commission57 make clear that as of January 2017 a large number, but by no means all, local authorities in Ohio had municipal aggregation schemes. The maps reveal two characteristics: (i) aggregation of electricity demand is more prevalent than of gas demand; and (ii) the state capital, Columbus, is an anomaly compared to the large urban areas of Cleveland, Cincinnati and Dayton, in having almost no municipal aggregation schemes. One possible explanation for this discrepancy is the collapse of the aggregation scheme that covered Cleveland (see Littlechild, 2008)); as of 2008, 204 municipalities, townships and counties58 had chosen to adopt municipal aggregation for electricity59, with ballot initiatives for aggregation only failing 11 times.

54 An example of material attempting to do this would appear to be Radner and Hempling (2000).
55 See https://en.wikipedia.org/wiki/Community_Choice_Aggregation
56 Quotes from the organiser of the scheme are available at: http://www.local.org/califor3.html
58 Littlechild notes that these municipalities varied in size from Cleveland with 224,000 households to Centreville with just 50 households.
59 Littlechild reports that 85% of these communities (174) had also voted for municipal aggregation regarding gas. However, Littlechild suggests that the higher volatility of gas prices and the fact that incumbent utilities already procure it through an auction process makes it harder for gas municipal aggregation to be effective. That gas is already procured through auctions limits the competitive benefit from aggregation and the price volatility
Colton (2006) argues that the emergence of municipal aggregation schemes was not evenly dispersed across the state of Ohio, with small communities being less likely to establish municipal aggregation schemes. For example, while 61% of Ohio ‘places’ in the top decile of places by number of households operated a municipal aggregation scheme, only 2.8% of those places in the bottom decile had a community aggregation scheme. Colton suggests this difference arises both from smaller communities having fewer resources to establish aggregation schemes and that the lower load from smaller communities make them less appealing to consultants. Colton also reports a corresponding relationship between the income of ‘places’ and their likelihood of having a municipal aggregation scheme: 46.7% of places in the top income decile adopted aggregation compared to only 2.8% of places in the bottom income decile. Colton also notes that individuals who were ‘not current’ on their bills, i.e. were in debt, were excluded from municipal aggregation schemes. However, Littlechild (2008) points out that this applies only to gas (and not to electricity) aggregation schemes.

Littlechild (2008) provides a partial counterpoint to Colton’s arguments regarding municipal aggregation schemes being more likely to be established in larger, richer communities. He suggests that the Colton analysis may be weakened as it did not remove areas covered by rural electric cooperatives, which are excluded from aggregation schemes by law, and that these areas tend to be smaller and poorer. Littlechild goes on to present some evidence that an alternative determinant of aggregation schemes being established is the size of energy bills/potential savings.

An institutional ‘quirk’ of the Ohio setting highlighted by Colton (2006) is that municipal aggregation involve risk for individual consumers due to the existence of ‘return pricing policies’, financial penalties imposed when a consumer who has opted out of supply by the local utility chooses/is forced to return to the local utility. In 2005 it appears that the Ohio Public Utility Commissioner allowed the incumbent supplier to charge an additional margin of 5% to returning customers, as well as a surcharge for any remaining unrecovered costs. Consequently any collapse of a winning supplier in a municipal aggregation scheme would impose a real cost on consumers, who would then be charged the ‘return price’. However Littlechild (2008) argues that this risk is overplayed as return pricing only occurs when an aggregator is unable to find a replacement for the collapsed supplier. The crucial factor is likely to be how large this possibility looms in the minds of potential consumers/voters.

Whatever the consequences, as Colton (2006) and Littlechild (2008) explain, the risk of the winning bidder reneging on its contract is real, with NOPEC finding in 2005 that the winning energy firm, Green Mountain Energy Company (GMEC), terminated its contract only months after signing a renewal contract covering 2006 to 2008. Littlechild (2008) argues that a key reason for this collapse was the interaction of the municipal aggregation auction with partial regulation of the Ohio electricity market. Deregulation had initially involved time limited ‘Electric Transition Plans’ to manage the transition to fully competitive markets; when these plans came to an end new ‘Rate Stabilisation Plans’, i.e. continued regulation of major utilities, were put in place to cover the period 2006-2008. NOPEC argued against these plans as a threat to its business model. Littlechild goes on to explain that when GMEC collapsed NOPEC customers did not suffer from the return pricing penalty as NOPEC was able

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means that whether an aggregation scheme’s auction produces a ‘good’ deal relative to the incumbent utilities’ deals depends on the timing of the auctions and the period for which prices are fixed.

60 It appears that California explicitly requires indebted customers to be included in municipal aggregation schemes.

61 Littlechild notes that there appears to be a correlation between the “Average low income electricity bill” in 2002 and whether or not the number of communities choosing to aggregate in an incumbent utility’s territory is more or less than ‘proportionate’. It appears that ‘proportionate’ number of schemes is defined by the total population in an incumbent’s territory.
to secure a new deal from FirstEnergy, the local distribution utility.\(^{62}\) While NOPEC was able to find an alternative supplier, Littlechild reports that the cities of Cleveland, Euclid and Cleveland Heights, along with NOAC in the Toledo Edison territory, were unable to find an alternative supplier for the period 2006-2008. However, from the relevant paragraph of Littlechild (2008)\(^{63}\) it is not entirely clear which (if any) of these customers suffered from the return pricing penalty.

Colton (2006) strongly supports opt-out over opt-in aggregation, stating: “opt-out aggregation models are uniformly endorsed as the necessary approach to municipal aggregation”\(^{64}\). This statement is, in part, likely to reflect the preferences of small communities and consultancies to minimise/remove the upfront marketing costs required by campaigns to encourage individuals to opt-in. Littlechild (2008) notes that the running costs of municipal aggregation in Ohio compare favourably to consumer acquisition costs in competitive energy markets, i.e. there are efficiency savings from not requiring consumer engagement. Littlechild reports that in 2005 NOPEC had an annual budget of below $600,000\(^{65}\) which translated into $11.50 per customer, while consultants providing gas aggregation services charged a fee equivalent to $5 per customer per year. This compared to a probable range of $30-$200 for the marketing and advertising costs of acquiring individual customers in the US, and an Ofgem figure for acquisition costs in GB equivalent to $40 at the time.

Colton also contrasts the designs of the Ohio and California opt-out mechanisms. In Ohio there was a relatively short opt-out period before schemes started, but then relatively frequent periods where consumers could revisit this decision. In California the initial opt-out period was longer, but there was no provision for subsequent periods when fee free opt-outs were allowed after the scheme had started. Colton (2006) reports that in Ohio consumers have two initial opportunities to opt-out. Once a community chooses municipal aggregation and has selected a particular supplier consumers are sent a notice explaining the situation at which point they have 14-21 days to opt out of the new supplier’s service. Then when consumers receive confirmation of their switch to the new supplier they are allowed to reverse this contract change for a short period, which is the second opportunity to opt out. After this point consumers can still move away from the supplier chosen by the aggregator, subject to a fee. Additionally all municipal aggregators are required to give consumers additional opportunities to opt out without having to pay a fee at two year intervals. In contrast, in California there are four initial opt-out points, two each in the 60 days prior to and following a switch. However, unlike in Ohio, after these initial opt-out points a consumer can only exit the supplier chosen by the municipal aggregator after paying a fee.

Lastly, Colton (2006) contrasts the Ohio approach to that of California regarding the type of energy supplies/contracts sought. In Ohio the contracts were short-term and focussed almost solely on the cost of energy, whereas in California contracts were signed with a length of 10-15 years to enable the aggregator to consider the life-cycle costs of energy efficiency and renewable energy schemes.

3.3.2 Massachusetts

Laufer et al (2013) reports six electricity aggregation schemes in Massachusetts. The first aggregation scheme was Cape Light Compact which serves 21 towns, which initially included the load from

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\(^{62}\) While NOPEC negotiated a small discount on FirstEnergy’s regulated standard service tariff, one might question whether this was achieved in a truly competitive way with Littlechild suggesting that the discount was “a quid pro quo for supporting the utility’s (First Energy’s) Rate Stabilization Plan” (quote from first paragraph, page 166).

\(^{63}\) First paragraph, page 187.

\(^{64}\) Third paragraph, page 3.

\(^{65}\) See reference 39, page 180.
municipal buildings as well as private consumers; this arrangement has since ended with municipal authorities participating in their own aggregation scheme organised by the Massachusetts Municipal Association.

Before a municipality can take part in an aggregation scheme in Massachusetts there must be a vote in favour at a city council or town meeting. As in Ohio, schemes are generally run by an intermediary who facilitates the opt-out process, provides ongoing customer support and monitors supply and utility rates to determine if the aggregation scheme needs to be ‘suspended’. The intermediaries finance their operations through a charge on the winning supplier, with the rate historically being $0.001 per kWh consumed according to Laufer et al (2013). The one exception to the use of intermediaries is the Cape Light Compact which performs the necessary administration in house. The Cape Light Compact is much larger than any of the other aggregation schemes, serving an area with a population of 200,000+, while the next largest aggregator had a population of only 40,000 and all the other aggregation schemes covering areas with populations below 16,000.66 The scale of the Cape Light Compact means it has also taken control of an ‘energy efficiency systems benefit charge’ which had previously been managed by the local utility. However, despite the scale and endurance of the Cape Light Compact, Laufer et al (2013) suggest it has not delivered significant savings to consumers. The Cape Light Compact appears to still exist with its website today appearing to have a partially ‘green’ tinge.67

Schemes are ‘suspended’ when either competitive energy prices are not below those of the ‘basic service’ (which seems to have had a regulatory cap until 2005) or a scheme is not meeting other community goals.68 While the scheme is suspended, consumers are returned to a utility’s basic service, until a cheaper competing supply can be identified. No democratic processes are required either to start or end a suspension, which appear to be purely commercial decisions. At the time of Laufer et al (2013) the aggregation schemes of Ashland, Lunenburg and Marlborough were suspended. Laufer et al (2013) note that the risk of prices ending up above those of a utility’s basic service and so incurring a suspension, was greatest when aggregation schemes set a fixed price that lasted for longer than the 6 months for which basic service rates were fixed.

In terms of the electricity supplies sought through the auction process, the Massachusetts Renewable Portfolio Standard requires that each year an additional 1% of energy is generated from renewable sources (in 2013 the total was 8%) and an aggregation auction may require suppliers to include bids on a ‘green’ option for consumers which exceeds this minimum standard. Laufer et al (2013) suggest that such flexibility means that the aggregation in Massachusetts can either be focused on minimising prices or on improving environmental provisions. The auctions tend to seek contracts lasting between 3 and 24 months.

The process by which consumers can opt out involves a mailing informing consumers that they are due to be switched at least 30 days prior to the switch being performed. The consumer then has 180 days to opt out of the aggregated deal without incurring a charge; beyond this time period a consumer can still opt out, although this may incur a charge. The communications must contain details of the local utility’s basic service rate and how an individual could choose a competitive supplier beyond the aggregation scheme. It appears from Laufer et al (2013) that Massachusetts may have an arrangement

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66 The Massachusetts aggregation schemes listed by Laufer et al (2013) are: Ashland, Cape Light Compact, Lancaster, Lanesborough, Lunenberg and Marlborough.
67 See http://www.capelightcompact.org/about/
68 It is unclear whether suspensions occur mid-way through energy supply contracts or whether they only occur when existing contracts naturally end, although, one presumes it is the latter.
similar to that in New Jersey, with consumers still receiving a bill from their existing utility, but with a breakdown detailing separately distribution charges (from the incumbent utility) and generation charges (from the winner of the aggregation auction). The consumer makes a single payment to their existing utility with the generation charges being passed through to the winning bidder.

### 3.3.3 California

The situation in California is described by Faulkner (2010) who was writing at a time when there was a proposition to change the state law to require approval by two-thirds of voters for an aggregation scheme to proceed. This proposal to require super-majority approval for aggregation was subsequently defeated, despite heavy funding in support of the proposition by the incumbent utility, Pacific Gas and Electric Company (PG&E). Faulkner reports that PG&E spent $30m backing this proposition, suggesting that the company viewed municipal aggregation as a serious threat to its business.

The first aggregation scheme approved by the California Public Utilities Commission was the San Joaquin Valley Power Authority, but this scheme was suspended in 2009 due to “market conditions” according to Faulkner (2010). Faulkner suggests that this failure was both due to the efforts of the incumbent utility and the scheme’s focus on price rather than green energy. The other Californian aggregation scheme identified by Faulkner as having started supplying energy by June 2010 was Marin Clean Energy (MCE). Faulkner details how MCE signed a five-year contract supply contract with Shell Energy North America in February 2010. The MCE scheme aggregated 80,000 customers and attracted bids from 12 companies. The winning bid matched the price that the incumbent PG&E was charging, but involved 78% of the electricity being generated from carbon free sources whereas only 53% of the electricity provided by PG&E was generated in the same way.

MCE still operates today, and declares itself successful by listing awards on its website, retaining a clear emphasis on green electricity. MCE’s website appears to offer three tariffs to consumers: (i) supply by 50% renewable sources, (ii) supply by 100% renewable sources, and (iii) supply by 100% local solar sources. The website also identifies 10 other ‘established and emerging’ aggregation schemes as existing in California.

Faulkner (2010) reported the initial phases of MCE supply. With partial implementation of the opt-out and supply process involving only 7,500 customers. Prior to the supply of energy starting in May 2010, opt-out mailings were sent in February and March 2010, with two further opt-out mailings planned in May and June 2010. The opt-out rate resulting from the first two mailings was around 18% leading to around 6,000 customers starting to receive power in May 2010. Faulkner reports that during the period prior to May 2010 PG&E proactively contacted potential MCE consumers to encourage them to opt out. These efforts resulted in the California Public Utilities Commission prohibiting several of PG&E’s methods including: calling customers to opt out and transferring them to a PG&E representative, providing an opt-out form via newspaper advertisements and home visits requesting a verbal or written opt-out. Faulkner suggests that if the prices of MCE rose above those of PG&E,
MCE’s customers could switch back to PG&E for a small fee\textsuperscript{72}. One safeguard built in to the approval process for aggregation schemes is the requirement for potential aggregators to file an implementation plan with the California Public Utilities Commission so that a cost-recovery mechanism could be placed on the aggregator to “ensure that costs are not shifted to the customer of the incumbent utility”\textsuperscript{73}. Aggregation is also prohibited where electricity demand is met by a publically owned utility.

### 3.4 Additional Evidence from the EU

The adoption of collective switching, as led by iChoosr, developed on continental Europe before moving to GB. iChoosr states that it has been operating in the Netherlands and Belgium since 2008.\textsuperscript{74} Bates (2012) reports that iChoosr and its website at the time reported the following information:

- Over 500,000 registered customers in the Netherlands, Belgium and Germany for collective switches related to gas, electricity and heating oil.
- A switching rate of over 30% for participants but with variations across markets and partner organisations (note this figure is roughly double the switching rate calculated using the headline figures from the iChoosr’s UK website in 2017).
- Savings averaging €200-250 per household for a dual fuel energy contract.
- The winning bid represented an improvement on existing tariffs for 95% of participants.

Bates (2012) notes a number of other organisations on the continent which aim to harness the collective buying power of consumers to obtain better deals. Since the organisations’ websites are unavailable in English it has not been possible to assess how far all the organisations’ business models conform to that of true collective switches. Bates provides the following details:

- Consumentenbond\textsuperscript{75}: This is a Dutch consumer body which in 2011 ran an energy collective switch in conjunction with the price comparison service Prizewize. As with the iChoosr model, Consumentenbond marketed the scheme to consumers, while Prizewize provided the infrastructure for the auction and switching process. The two organisations shared the revenue generated by the initiative. The bids solicited from suppliers included a “retention offer” for participants. The first round of this collective switch was advertised mainly to Consumentenbond’s members and resulted in 23,000 switches. A second round included marketing on radio to non-members and resulted in 34,000 switches. Consumentenbond was planning to run a third collective switch in May 2012.
- United Consumers\textsuperscript{76}: A consumer ‘collective’ that negotiates mass discounts in utility markets on behalf of its half a million members.
- Woonergie\textsuperscript{77}: An initiative of a federation of Dutch housing associations where the electricity and gas demand of their tenants is aggregated to achieve better deals. As of 2012 the discounts were benefiting 70,000 tenants.

\textsuperscript{72} The current online opt-out form used by MCE in 2017 is available at: https://www.mcecleanenergy.org/opt-out/
\textsuperscript{73} See first paragraph on page 7 of Faulkner (2010).
\textsuperscript{75} See https://www.consumentenbond.nl/
\textsuperscript{76} See https://www.unitedconsumers.com/
\textsuperscript{77} See https://www.woonenergie.nl/
• ACW Limburg\footnote{See https://acv-limburg.acv-online.be/default.html}: Involves 15,000 residents of Limburg in Belgium coming together to use their buying power to secure better gas and electricity deals.

3.5 Summary of Collective Switching Evidence

We have identified collective switches as schemes which harness buyer power to deliver offers which are better or more available than those already in the market. The general lessons relate to opt-in vs opt-out, engagement, retail vs wholesale, democratic mandate, and general design.

The lessons from GB are that for opt-in schemes, switching rates have been relatively low as has additional engagement in the market. The modest success of opt-in processes, has been observed elsewhere. The success in the US, where opt-out is much more common and schemes are relatively local, may be driven by a combination of factors, including a mandate from local elections and a focus on purchasing supply to be delivered through incumbents. This means that the insights from the US examples are not directly transferrable to the GB context.

One important insight is the overall variation in design. While we have emphasised that the central features of collective switches are the auction process and the harnessing of buyer power, there are a number of variations to the basic collective switching model in principle and in practice. Key variations could include:

• Opt-in vs Opt-out sign-up model
• Differences in the auction design and criteria for participation by firms e.g. emphasising green energy tariffs
• The auction mechanism only applying to the wholesale component of the bill
• Requirement of a further opt-in to complete a switch after receipt of an offer
• Automatic switching when the winning offer exceeds a specified saving figure
• Outreach work to boost participation by vulnerable groups
• Length of time for which the winning deal lasts
• Ability to opt into/opt out of a winning collective switch deal during the life of the deal
• A safeguard mechanism to ensure the winning deal in the auction is actually the cheapest deal in the market for individual consumers
• Repetition of the auction process with participants being reminded when their pre-existing collective switch deal is about to expire
• Online only service vs paper and telephone sign-up
4. Evidence on Opt-In vs Opt-Out Mechanisms

A central consideration when evaluating the use of a Disengaged Consumer Database for a collective switch is whether the switch should take place on an opt-in or opt-out basis; in other words, should the switch only include consumers who have taken a positive step to be part of it, or should all consumers be part of the switch unless they take a positive step to opt out of it? This design issue is a specific example of a wider issue explored in the economic literature on the role of default options, i.e. the outcome when an individual takes no action. In this section we review this literature, in particular, the empirical results regarding the power of defaults and possible explanations for and interpretations of this power. The potential legal issues when choosing between opt-in and opt-out mechanisms are discussed in Appendix B.

The role of default options in individual decision-making is well documented in the empirical and experimental literature. A large proportion of individuals choose the default option in decisions both in financial settings, such as pension savings and insurance, and in non-financial settings, such as organ donation and Internet privacy policies. The power of the default option contradicts the predictions of neoclassical economics, where standard choice theory dictates that the design of choice problems, in particular the selection of one of the alternatives as the default, should be irrelevant; the consumer is expected to pick the option that maximizes her utility, irrespective of the choice design. Many potential explanations have been suggested for the attraction of the default, including inertia (Kahneman and Tversky, 1982; Landman, 1987), status quo bias (Samuelson and Zeckhauser, 1988), procrastination (O’Donoghue and Rabin, 2001), interpreting defaults as endorsements (Madrian and Shea, 2001; McKenzie et al., 2006; Beshears et al., 2009), as well as choice overload and the complexity of choice problems (Agnew and Szykman, 2005).

4.1 Individual decision-making: opt-in versus opt-out designs

The central stylized fact in the empirical and experimental literature is that whether choices are presented in an opt-in or an opt-out fashion has a strong effect on the outcome. A cardinal example is that of organ donor registers. Johnson and Goldstein (2003) note that countries where citizens are assumed to be willing to donate their organs unless they opt-out have more potential donors registered than countries where citizens are assumed to be unwilling to be an organ donor unless an explicit, i.e. opt-in, consent has been given. Simply framing something as a default appears to significantly influence the choices that people make. Large differences between opt-in and opt-out designs are also found for the number of consumers giving online permission for inclusion in e-mail distribution lists for future contact (Johnson et al., 2002) and when selecting car insurance plans (Johnson et al., 1993).

Opt-in versus opt-out designs have a large influence on retirement saving decisions and thus a significant impact on citizens’ welfare. Madrian and Shea (2001) evaluate the consequences of a large US company changing the opt-in nature of its 401(k) retirement savings plan to an opt-out design. Immediately participation rates rose from 37% to 86%. The power of defaults was further illustrated by the vast majority of workers contributing the default premium rate and investing all their contributions into the standard fund. Choi et al. (2004) find that automatic enrolment into retirement savings plans (i.e. an opt-out design) is particularly successful at raising the participation rate of lower-paid employees, demonstrating the influence of personal characteristics and circumstances on

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79 Stadlbauer et al. (2013) report that in Austria (with an opt-out policy) 75% of the population were registered organ donors in 2010, while in Germany (which has a similar language and culture, but an opt-in policy) only 12% of citizens were registered organ donors.
response. Employees hired under automatic enrolment rules had pension participation rates at least 30 percentage points higher than employees who had had to opt-in to a pension scheme.

Defaults in pension choices play an important role beyond the US. For example, Cronqvist and Thaler (2004) document how, following the privatisation of social security in 1999, Swedish citizens were sent a catalogue of 456 mutual funds and given instructions on how to invest for their own future. One-third of participants chose to put their entire investment in the default fund, despite an extensive educational campaign encouraging them to make active decisions. The proportion of default choices rose to 93% three years later after the government had stopped its publicity campaign. In Switzerland, some company pension funds pay out accrued employer pension savings as a lump sum, while other funds transfer the capital into a lifetime annuity. Büttler and Teppa (2007) report that while all companies offer the possibility to opt-out of the standard option, a large majority of Swiss pension fund members take the default pension fund option on retirement. The analysis by Büttler and Teppa is based on micro administrative records from ten Swiss pension sponsors and involves choices concerning the use of substantial sums (approximately $400,000 on average).

When choices involve more than two alternatives, defaults sometimes exhibit even stronger effects. Park, Jun, and Maclnnis (2000) find that consumers chose a car with a more expensive set of features if the default was a car including all features from which particular features could be removed versus a basic car to which they could add features; they find similar results for treadmills and personal computers. Computers are pre-loaded with a multitude of default settings (e.g. the operating system, web browser, and its search engine), and many people never change these settings as Mackay (1991) explains. However, in the case of computers, many consumers may not even realise that they have the power to change settings or how they would go about doing so.

4.2 Explanations for the Influence of Defaults

Johnson et al. (1993) note that in the early 1990s, both New Jersey and Pennsylvania passed legislation requiring every driver to choose between two insurance alternatives: a high-cost insurance policy that provided the right to sue or a low-cost policy that lacked this right. New Jersey law mandated the inexpensive policy as the default, and Pennsylvania law mandated the expensive policy as the default. The defaults appeared to exert tremendous influence on the choice of insurance: 21% of drivers in New Jersey purchased the right to sue, compared with 70% in Pennsylvania. Johnson et al estimated that $140 million more auto insurance was purchased annually in Pennsylvania because of the default. The behavioural economics literature has argued that default options can influence choices in three main (potentially overlapping) ways (see Smith et al. (2013) for a review):

(a) Defaults affect the perceived meaning of choices and associated actions: evidence suggests that defaults are interpreted as being the recommended option, or as being “implicitly endorsed” (Brown and Krishna, 2004; McKenzie et al, 2006). Similarly, recent work on the “change-in-meaning” account of default effects has suggested that default effects may occur because people attach different meaning to behaviours they have to opt in to perform, versus those they have to opt out of (Davidai et al, 2012). Supporting this, Davidai et al (2012) in the context of organ donation showed that within an opt-in country, donation was considered morally akin to giving away half of one’s wealth to charity upon one’s death, while in an opt-out country, it was considered similar to letting others jump ahead of you in a line and volunteering some time to help the poor. Differences in meaning may influence (and in turn be influenced by) other determining factors, in particular, perceived norms. Numerous investigators have shown that perceived norms can have a very large—and often under-estimated—impact on people’s decisions. Thaler and Sunstein (2003) suggest that the default selected by policymakers might be interpreted as an indication of what the majority chooses, while in a
commercial context, Brown and Krishna (2004) posit that defaults set by advertisers may be perceived as suggestions.

(b) Default options often require less effort for the decision-maker: people may follow a default because they do not want to exert the effort of changing to the non-default option, which may include (in organ donation, for example) acquiring and mailing a change-of-consent form (Samuelson and Zeckhauser 1988; Johnson and Goldstein, 2003). Yet, effort cannot be the complete picture, for default effects are also shown to occur in cases where switching to the non-default requires minimal effort such as a click of a button. Instead, individuals may postpone difficult or unpleasant decisions and choose to spend their time in a way that provides more immediate gratification. This is consistent with empirical evidence on time inconsistent behaviour arising from individuals using a short-term discount rate which is higher than the discount rate used for decisions in the more distant future. As a result, individuals may ‘rationally’ postpone decisions, possibly until the need for the decision is forgotten (Samuelson and Zeckhauser 1988; Thaler and Sunstein 2003).

c) Default options invoke cognitive biases, perhaps driven by loss aversion and the anchoring of decision-makers to the status quo: the tendency of individuals to stick to the current situation may simply reflect a preference for the status quo situation (Samuelson and Zeckhauser, 1988). This preference may be explained by a combination of loss aversion, i.e. decision-makers weigh losses more strongly than gains (Kahneman and Tversky, 1979), and the fact that the status quo serves as a reference point for their loss evaluation. People feel a sense of possession over the default option, so that giving up this endowment is perceived as a loss; such a loss looms heavier in the mind than the equivalent gain achieved by changing to the non-default option (Kahneman and Tversky, 1984; Ritov and Baron, 1990).

The three sets of explanations described above are not mutually exclusive and are likely to work together: accepting the default may save time, effort, and money while one’s conscience may also be salved by the sense that a policymaker is endorsing the default as the socially desirable behaviour.

4.2.1. The Link to Social Norms

Both the change-in-meaning account (Davidai et al., 2012) and the implied recommendation account (McKenzie et al., 2006) highlight the perception of defaults in a social context, displaying clear parallels with the concept of social norms. Social norms refer to an individual's beliefs about the common or accepted behaviours within a group (Cialdini and Trost, 1998).

Individuals are often motivated to act in accordance with perceived social norms (Deutsch and Gerard, 1955). Such social norms include both descriptive norms, concerning an individual's beliefs about how common the behaviour is within a group; and injunctive norms, which refer to an individual's beliefs about the approval for a specific behaviour among group members (Biel, Eck, Garling, 1996). People are more likely to be influenced by social norms if there is a perception of ambiguity about what should be carried out (Crutchfield, 1955; Reno et al, 1993). Messages utilising both descriptive and injunctive norms have been used to promote prosocial behaviour in general (e.g., Penner et al, 2005), as well as in the specific contexts of charitable donations (Croson and Shang, 2010) and pro-environmental choices (Schultz and Kaiser, 2012).

In an experimental study, Everett et al. (2015) provide evidence for the existence of default effects in altruistic contexts (charitable donations), as well as demonstrating an explanatory role for social norms. Everett et al (2015) found that: (i) participants preferred the default option when considering charitable donations; (ii) participants perceived the default option to be the socially normative option; (iii) that perceptions of (primarily descriptive) social norms influenced the effect of the default on
donation amounts; and (iv) participants translated social norms they inferred from the default option in one domain into behaviour in a second, related domain, suggesting a transfer effect in social norms.

4.3 Default options, individual autonomy and ‘libertarian paternalism’

Since defaults alter choices, they may violate consumer autonomy by serving the marketer’s/policymaker’s interest rather than the consumer’s/citizen’s. Such violation of autonomy may occur paternalistically, i.e. is intended for the consumer’s own good. The trade-off between maximizing autonomy and welfare is illustrated in classic paternalistic interventions by the state, such as laws requiring seat belt use in cars or helmets for motorcycle riders.

Sunstein and Thaler (2003) argue strongly in favour of a form of paternalism, urging that default rules "should be chosen with the explicit goal of improving the welfare of the people affected by them."80 Sunstein and Thaler’s (2003) rationale is that "in some cases individuals make inferior decisions in terms of their own welfare—decisions that they would change if they had complete information, unlimited cognitive abilities, and no lack of self-control."81 Moreover, given their belief in decisions being constructed, Sunstein and Thaler suggest that in many situations, there is no alternative to a form of paternalism: somebody must choose the default, and it makes sense to ensure it is beneficial.

It is noted that this ‘weak paternalism’ cannot be avoided, even where planners avoid defaults and instead require individuals to make active choices, since some people choose not to choose and a default is required. Sunstein and Thaler (2003) advocate ‘libertarian paternalism’, under which, they suggest, paternalistic policies that are "self-consciously attempting to move people" would be acceptable from a libertarian perspective if options are not blocked off and impose only “trivial costs on those who seek to depart from the planner’s preferred option".82 This is the central idea in ‘Nudge’ (Thaler and Sunstein 2009). In setting defaults, marketers/policymakers potentially could follow ‘libertarian benevolence’, whereby default rules are "enlisted in the interest of vulnerable parties" (Sunstein and Thaler 2003, p. 1162). Sunstein and Thaler argue this approach remains libertarian because the design makes it easy to reject the default option.

Nevertheless, even libertarian paternalism violates pure autonomy. Sunstein and Thaler (2003) acknowledge this concern up to a point, though they assert that it is “fanatical” in settings such as obesity "to treat autonomy ... as a kind of trump not to be overridden on consequentialist grounds".83 If the effect of defaults results from laziness or implied endorsement, perhaps giving people the ability to choose an alternative path does adequately restore autonomy. However, this appears less than obvious when cognitive biases are used to explain default effects, despite what Sunstein and Thaler (2003) suggest: setting defaults to utilise cognitive biases relies inherently on the fact that many consumers do not have the conscious ability to override these biases and so are ‘unable’ to choose the alternative path. Intuitively, the freedom to choose is curtailed in consumers who display cognitive biases.

4.4 The possibility of Active or Forced Choice

One alternative to specifying a default option might be an active or forced choice. As Carroll et al (2009) explain an ‘active decision’ regime is one where there is no default and individuals are forced to choose between options. In the context of retirement saving, Carroll et al (2009) argue in favour of

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80 See page 1161, Sunstein and Thaler (2003)
81 See page 1162, Sunstein and Thaler (2003)
82 See page 1162, Sunstein and Thaler (2003)
requiring people to make active choices relative to a default of automatic enrolment or non-enrolment (uncoerced active choice) when consumers have a strong propensity to procrastinate and savings preferences are highly heterogeneous. In the retirement saving case Carroll et al suggest that there is significant heterogeneity in the optimal action across individuals with the optimum varying systematically with age. They find that introducing an active choice design led to participation in a firm’s 401(k) pension scheme increasing by 28 percentage points compared to a situation involving a default of non-enrolment. Building on this work, Keller et al. (2011) find positive results for enhanced active choice (forced choice supported by the endorsement of the preferred option by the choice architect) in the context of adhering to medication.

However, Carroll et al (2009) also note that a default enrolment approach is preferable to compulsory active decisions when consumers are fairly homogeneous and decision makers have limited expertise. Given that energy consumers’ preferences are generally thought to be fairly homogeneous, i.e. they want a secure supply with reasonable customer service at the lowest price, and it is generally believed that the disengaged tend to have less ‘expertise’ than the engaged, it suggests that a default of participation in a collective switch, with possible opt-out, is more appropriate than an active choice structure. There are also limits to the credibility of forcing an active choice in the energy market context. Employers can plausibly force employees to make a decision, but for energy consumers the most plausible penalty would probably involve terminating a consumer’s energy supply contract, and such disconnections appear both socially undesirable and to breach energy licence conditions.

Work on reason-based choice by Shafir, Simonson, and Tversky (1993) demonstrates that the addition of more options increases the tendency for individuals to remain with the status-quo default. The most important factor, perhaps, is that the expansion of choice significantly increases the effort involved in making a decision (Payne, Bettman, and Johnson 1993).

4.5 Benign Defaults and Smart Defaults

Since ignoring the power of defaults is not an option, not least because where we cannot force choice there will always be a default, Sunstein and Thaler (2003) propose the use of benign defaults. If the default is set to the choice most people would be presumed to make when making an active and unconstrained decision, the greatest number should benefit. Implementing such an approach may not be as simple as it seems, because setting the wrong defaults may impose great costs on individuals.

Sunstein and Thaler (2003) propose four types of interventions: (1) minimal paternalism, in which a planner constructs a default rule with the goal of influencing behaviour, and it is costless or nearly costless to depart from the default plan (this intervention is most consistent with their idea of libertarian paternalism); (2) required active choices, in which the planner is unsure which choice will promote welfare and so forces people to choose explicitly (though this can be problematic in many contexts, as discussed above); (3) procedural constraints, which typically require more effort and are designed to ensure that departing from the default is voluntary and rational rather than a function of flawed decision making (e.g., due to a lack of experience); and (4) substantive constraints, which allow people to reject the default but only on certain terms and potentially at considerable cost as well as effort.

An example of a benign default falling into category (1) is the approach of Disney theme park restaurants in providing healthy side dishes as the default offering with a main meal and leaving it to customers to specify a less healthy alternative if they wish (Walt Disney Company 2009). Disney's policy helps address the obesity epidemic by providing healthier meals but makes it easy for customers to opt out, consistent with Thaler and Sunstein's libertarian paternalism.
Goldstein et al (2008) describe the possibility of ‘smart defaults’. Focusing on commercial companies, Goldstein et al suggest that as marketing professionals aim to understand consumers’ needs and predict their behaviour, this knowledge could be used to design individualised defaults: a smart default uses customer information to generate individualised options that are more likely to be optimal for a specific customer than a generic set of alternatives. In the context of helping decision making around the purchase of retirement investments, a smart default might be set to vary according to the purchaser’s age, family status, and intended age at retirement. Other factors, such as the investor’s risk preferences and/or loss aversion could also be included. While these defaults would not suit all consumers they might be superior to the traditional default of no contribution or a ‘one-size-fits-all’ default contribution.

The main potential issues around smart defaults appear to be: 1. how to identify and warn consumers for whom the smart default is likely to be a poor fit, 2. the availability of consumer data to perform the necessary modelling, and 3. consumer discomfort with a firm, or other organisation, using detailed information to separate or ‘discriminate’ consumers towards different options, and confidence that the information was being used in the consumers’, rather than the firm’s, interests.
5. Using a Database for Collective Switching

In this Section and Appendix A different options for the use of a Disengaged Consumer Database are presented, each following the same format: description, advantages, disadvantages and issues. In identifying advantages, disadvantages and issues this section and Appendix A focus on the economic and design/organisational issues, while the main legal points are discussed in Appendix B. The discussion of the collective switching proposal is fully developed in this section, and the discussion of other options in Appendix A is abbreviated to bullet points.

Description of the Proposal and General Discussion: A reverse auction would be held to determine the supplier(s) who would provide disengaged consumers with energy. Since the existing stock of disengaged consumers is around 10 million households\(^84\) this total pool of consumers would need to be broken down into ‘blocks’, with suppliers bidding to supply individual or multiple blocks. For each block of consumers the winning supplier would be the one providing the lowest price\(^85\), subject to meeting minimum service standards. The size of the block needs to be chosen so that the blocks are small enough for small energy firms to feel that they can ‘digest’ the quantity of new consumers while maintaining decent customer service. For TBS the Co-Op initially placed a limit of 30,000 new consumers on the number of switchers it would take on if it won TBS auction, as described in section 3. Assuming a block size of 25,000 households is reasonable, the initial stock of disengaged consumers would need to be split into 400 blocks; a smaller block size of 10,000 would imply 1,000 blocks to be auctioned.

A key choice will be the design of the mechanism to auction the blocks. A discussion of the types of issues faced when selecting an auction mechanism is provided by Salant and Loxley (2004) in relation to the selection of the mechanism for the New Jersey municipal aggregation scheme. While we are not in a position to identify the optimal auction mechanism (which would be a discrete and specialist piece of work), based on our current understanding there appear to be two main options:

(i) Auction the blocks sequentially: Each block is auctioned in order. The order of auctioning the blocks may be random or, if blocks are designed to have different but specified characteristics, a particular order might be chosen. As there is a separate auction process for each block it is likely that different winning prices will apply to each block. As Salant (2003) notes, the relationship of the price offered for a block and its position in the order of the blocks being auctioned is potentially ambiguous because of two effects, each operating in an opposite direction. The first, more intuitive, is that the lowest cost and most aggressive firms will bid for early blocks; but they may face capacity constraints which prevent them from bidding later in the auction process, so that prices rise for later blocks. Conversely, the theoretical optimal bidding strategy is to bid less aggressively for the early lots. The intuition is that if a bidder bids less aggressively in the auctions of early blocks and fails to win, it retains the possibility to act more aggressively for later blocks. As the number of blocks remaining to be auctioned declines this ‘option’ to delay aggressive bidding declines, and so the aggressiveness of observed bids would be expected to increase.\(^86\)

(ii) Falling ‘clock’ auction: Salant and Loxley (2004) explain that this was the auction mechanism, in which all blocks are auctioned simultaneously, chosen for the New Jersey municipal aggregation scheme (see section 3). The ‘clock’ announces the price in a particular round of the auction and bidders

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\(^84\) Information received from Ofgem.

\(^85\) By price we mean the tariff that consumers face when they consume energy.

\(^86\) Ashenfelter (1989) and McAfee and Vincent (1993) explore sequential auctions involving multiple lots of identical (wine) products which generate varying prices across the lots offered.
enter the number of blocks they are willing to supply at the specified price. The first posted price is set well above what is expected to be the final auction price, and in each round the price is reduced by a specified amount. As the price drops in each successive round the number of blocks individual suppliers are willing to supply is likely to drop, and eventually high cost suppliers will withdraw from the auction when the price falls below their costs. The price will continue to drop until the total number of blocks that suppliers are willing to supply equals the number of blocks on offer, at which point the auction stops. The main appeal of this auction mechanism is that it ensures that all blocks receive the same price, which is an attractive feature if all the blocks are formed so that their aggregate characteristics are representative of the total pool of consumers. As there is a common price across all blocks the winning price is likely to be above cost for the lowest cost suppliers. If the potential for a small number of suppliers to win the majority of the blocks is deemed a concern, a cap could be placed on the number of blocks that any individual supplier could win/supply.

Beyond the design of the auction mechanism, the first variation of this proposal is whether disengaged consumers opt in to the auction or are automatically placed in the auction unless they opt out. The second variation is whether the auction is held only once or is repeated regularly as consumers who currently have spent less than three years on a default tariff move past the three year threshold.

Many of the generic advantages and disadvantages of collective switch auctions described below vary in their probability and extent, depending on whether an opt-in or opt-out mechanism is adopted. The evidence provided in Sections 3 and 4 indicate much greater participation rates in an opt-out auction, with correspondingly starker outcomes, and implications for both disengaged consumers and the wider energy retail market, including on currently active/engaged consumers.

The difference in participation rates between opt-in and opt-out approaches will depend on the number of opt-in/opt-out decisions a consumer is required to take before they are switched. The minimum number of such decisions is one, with a single decision simultaneously determining whether a consumer is placed on a disengaged consumer database, they are entered into the collective switch auction and they are automatically switched after the auction has concluded. An alternative might involve three explicit opt-in/opt-out decisions: 1. to be placed on the database, 2. to be entered into the collective switch auction, and 3. to accept the winning offer in the auction. To illustrate the effects of these choices, suppose the participation rate at each decision is 20% if an opt-in mechanism is used and 80% if an opt-out mechanism is chosen. With a single decision the rates of consumers switched are 20% and 80% respectively, while with three opt-out decisions 51.2% of consumers are switched and with three opt-in decisions a mere 0.8% of consumers would be switched. In a plausible scenario where two decisions are required (to be placed on the database and to accept the offer which wins the auction), using an opt-in design, the percentage of consumers switched would in this example be 4%.

This discussion about the final percentage of consumers who are switched highlights a key question: how is ‘success’ defined? What outcomes must be achieved by a disengaged consumer database for the political ‘heat’ around the prices charged to default tariff consumers to be removed? Using the 4% figure for illustrative purposes, it seems that a key issue will be whether success is judged by the absolute number of households helped or the percentage of disengaged consumers that receive a

87 While we do not suggest that these participation rates will actually occur, they do seem possible given the evidence presented in Section 3. Both values also imply that the same percentage of households, 20%, take a positive action when presented with a decision.

88 An alternative could involve a combination of opt-in and opt-out mechanisms at different points in the process.
better deal. As a percentage of disengaged consumers 4% seems unimpressive, but would represent around 400,000 households, a significant number. This combination of figures suggests that a plausible end result of running a collective switch could be impressive from a cost-benefit perspective, but insufficient to address the fundamental political question surrounding disengaged consumers.\textsuperscript{89} Equally, the issue of percentages versus absolute figures may run in reverse if something goes wrong with the collective switching process; a 0.5% error rate might seem low, but could result in tens of thousands of households feeling aggrieved.

**Advantages:** The main advantage of a collective switch auction to supply consumers is that it harnesses competitive pressure which should ensure that the consumers in the auction receive a lower price than that which default tariff consumers currently receive. The ability of an auction to reveal the actual costs of firms, with the lowest cost firms in theory winning the auction, has a benefit over price regulation for default tariffs in the sense that it avoids the central challenge of price regulation, determination of the regulated price. Moreover, rather than replacing competition, an auction mechanism represents an alternative form of competition for, rather than in, a section of the market.

If the CMA’s central concern is that disengaged consumers suffer detriment because their behaviour results in a lack of competitive pressure to drive down default tariffs, an auction addresses this harm directly and should generate strong competitive pressure between firms. Furthermore, if the reason for consumer disengagement is thought to be high search and switching costs, a centralised mechanism where individual consumers do not have to search or provide information to alternative suppliers potentially offers efficiency gains over a decentralised market. Such gains constitute the aggregate reduction in search costs across all the consumers taking part in the auction, plus the aggregate reduction in switching costs from the consumers who switch, minus the centralised administration costs of running the auction. Further efficiency gains result from any consequent reduction in firms’ marketing expenditure.\textsuperscript{90}

**Disadvantages:** There are upfront costs to design and run the auction, though these should hopefully be outweighed by potential benefits in terms of price reductions for large numbers of default tariff customers. More serious concerns relate to: (a) the likely outcome of the auction; (b) the organisational challenge of switching millions of households’ energy retailing contracts en masse; and (c) the impact of auctions on the long-term trajectory for the wider retail energy market.

The design of the auction mechanism will be critical in determining its outcome. If blocks of consumers are auctioned sequentially, it is unlikely that all consumers will receive the same price. Another risk regarding the auction outcome is that the winning bidders win with unrealistically low prices and subsequently collapse. There are two levels to this issue; the first is that the world changes after the auction has taken place and a price that was expected to be profitable at the time of the auction turns out to be unprofitable. This risk seems inherent to any situation where the price is fixed, and suggests that the period for which the time is fixed should be limited. Ofgem’s existing arrangements for an effective resolution process for retailers in financial trouble to ensure continuity of service and

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\textsuperscript{89} Of course, some might argue that once a consumer has been presented with the option to take part in a collective switch and they ignore/refuse it they are no longer truly disengaged as they are taking a positive step indicating that they do not wish to change supplier.

\textsuperscript{90} The likelihood of marketing expenditure being reduced by a noticeable amount is probably low as one assumes that a lot of existing marketing expenditure is aimed at getting engaged or partially engaged consumers, rather than disengaged consumers, to switch more often/in a particular fashion. Also, a significant proportion of large firms’ marketing efforts may be targeted at their existing customers in an effort to reduce the likelihood of them switching to rivals.
investigation of the financial position of potential suppliers prior to any auction should minimise the threat posed by this risk.

Another concern is if the auction systematically leads to firms or, more precisely, senior management within these firms, making unrealistically low bids to avoid the consequences of failing to win. This type of behaviour might be more likely to occur where a widespread departure of default tariff consumers could prove financially destabilising. Equally the risks of unrealistic bidding may be limited by the existence of multiple consumer blocks which should mean any auction is less of an ‘all or nothing’ process.

A second major challenge is the organisational task of switching hundreds of thousands and possibly millions of households’ energy supply contracts. If there is even limited success, for example the 4% of the stock of 10 million disengaged consumers posited above, 400,000 households would need to be switched in a short period of time.

As reported in section 3, we have been unable to find collective switches of equivalent scale which involve the full migration of retail accounts and billing between suppliers. The largest collective switch we have identified is the US municipal aggregation scheme of the Northeast Ohio Public Energy Council (NOPEC) which involved around 400,000 customers, but this seemed to involve no mass switching of customer accounts or billing arrangements.

In the absence of regulatory changes to enable an approach akin to US municipal aggregation, the maximum volume of customer migrations that supplier systems can handle in a given time period will need to be established. The need to break the existing stock of disengaged consumers into tranches that can be migrated between suppliers over time may mean that multiple decreasing clock auctions will need to be held, or the migration of consumer accounts to the winning suppliers of a single auction may need to be staggered over a number of months. While the costs of running the auction process itself may be relatively low, the costs of migrating consumer accounts may be far greater if multiple waves of consumer communications are required, extra call centre staff need to be hired and/or computer upgrades are needed. The migration of consumers may raise particular issues if firms differ in their abilities to handle increased customer volumes, especially if those losing large volumes of customers, as well as those winning business, need to make investments in such processes. Lastly, there is the potential for such a large migration of consumers to result in errors affecting many households.

The third set of disadvantages relate to the impact of the collective switch/auction on the wider retail energy market. If the auction is imposing effective competitive pressure on one part of the market, there will be effects on both the average level of prices (which would fall if there are currently excess profits) and on the balance between prices charged to different consumers. If the higher prices for disengaged customers simply reflect a greater proportion of fixed costs being allocated to those consumers with more inelastic demand, i.e. firms are currently earning a ‘normal’ level of profits.

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91 However, the risk of financial destabilisation should not be overplayed since it will only relate to firms’ retail division. Even if a retail division has a forward contract covering the energy for all its default tariff consumers, it is not automatic that there would be a terminal crisis for the firm as the end demand for energy will still exist. In other words, the forward contract will still have value, as long as the company losing default tariff consumers can resell the energy covered by the forward contract back into the wholesale market.

92 While Section 3 reports that the Italian ‘single buyer’ AU covers 27 million households, we do not have clarity on the precise billing arrangements of consumers; however, it seems probable that, as in the US, no migration of customer accounts occurs with AU’s primary purpose being buying on the wholesale market.

93 As soon as multiple auctions are held there is the issue of different auctions ending in different prices for consumers and possible dissatisfaction around this point.
overall, it raises the question of how firms will recover their fixed costs when collective switching increases the competitive pressure on default tariffs. We would expect some rebalancing of fixed costs from households taking part in the auction to households elsewhere in the market: while those taking part in the auction should see price decreases compared to their current default tariff prices, currently engaged consumers on fixed tariffs may experience price rises. Default tariff customers who do not opt in, or choose to opt out may also face even higher prices than at present. The threat of a price increase to this group of consumers is particularly severe, since their presence in the database and their further choice not to switch indicates they have a particularly low price elasticity of demand.

One serious issue is that collective switching does not attempt to alter weak consumer response, indeed it creates an incentive to disengagement compared to the current arrangement of unregulated default tariffs (since the higher costs paid by the disengaged result in the savings between tariffs that are the benefits of engagement). In particular, with collective switching in place, the price gap between default tariffs and the fixed deals available to those who engage individually will almost certainly fall, reducing the incentive for a rational consumer, whether or not currently active, to engage with the market. With collective switching in place, if you do not switch for three years because it seems like a ‘hassle’, the scheme organiser will switch you to a cheaper deal with a minimum of effort. Why bother with the time consuming process of comparing deals and switching each year, if once every three years someone does it for you? That a collective switch would ‘turn on’ consumers to being engaged seems possible only for consumers who: (a) do not believe the savings available from switching are real, or (b) consider the process of switching (as opposed to searching) to be more time consuming than it actually is. Thus a collective switch may both deter future engagement by the disengaged, and reduce future engagement by the currently engaged (assuming that collective switches occur on an ongoing basis). Nevertheless a positive efficiency gain could result from reliance on a collective switch auction, as explained above.

**Issues:** Any auction mechanism will require design, so the auction organiser will have to take a series of explicit decisions which will directly influence the outcome achieved. The mere fact that these decisions are explicit and have predictable consequences means that they are likely to be contested by those groups who predict that they will lose out from the decisions. These explicit decisions may include topics that traditionally have been left to the market to decide. One of these questions is how frequently collective switches should be repeated? It seems unlikely that the CMA’s identified issue of consumer disengagement will be resolved in the near term even with the arrival of smart meters, and especially given the incentives provided by the collective auction itself.

The explicit design of the auction process and the broad ‘envelope’ of winning services could be beneficial as an opportunity for open discussions around each of the decisions. It may also mean the auction organiser has implicit control over the standard of service received by a large number of consumers. The downside is that, while any control is likely to be partial, the auction organiser will be held responsible by consumers if a winning bidder provides a poor service etc. Even basic aspects of the tariff structure will have to be decided by the auction organiser e.g. is the tariff fixed or variable? If the tariff is fixed, how long will it be fixed for? If it is variable, what will be the constraints on the variability? Will the auction organiser specify the price variations between regions and payment

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94 Beyond the rational incentive not to engage created by collective switching, following the discussion of Section 4, disengagement might increase further if consumers perceive that positioning the collective switch as the default option is an implicit endorsement by the scheme organiser.

95 By this we mean setting the parameters over which there will be competition and those parameters where a fixed standard will be set. It is unclear whether Ofgem’s new regulation ‘principles’ will be strong enough to ensure a high quality service when an auction based on price creates strong incentives for cost minimisation.
methods or will separate auctions be held for different regions and payment methods? What service standards must be met by winning bidders? The need to take these detailed decisions seems inconsistent with a more general move towards principles based regulation.

The biggest challenges for an auction organiser may prove to be those that relate to distributional issues. For example, will the auction blocks be formed from a random selection of consumers or be designed to group together consumers with similar characteristics? If it is the latter, it seems likely that firms will charge different prices based on the characteristics of the blocks. If it is the former, will there be complaints that ‘low cost’ consumers are having the opportunity to achieve even larger savings from ‘low cost’-specific blocks/auctions ruled out?

The design of the blocks influences the end price for consumers because it influences the bidding by suppliers. If the auction involves a series of rounds, each for a separate block of consumers, the choice of block size will not only influence whether small firms feel able to bid, it may also affect the risk of collusion with a greater number of smaller blocks potentially increasing the risk. An alternative risk is that firms do not to bid at all. The risk of non-bidding will be heightened if the auction design leads firms to anticipate that the winning bids will be only marginally profitable. The issue of non-bidding may also influence the quantity of information revealed about individual consumers’ consumption. The less information is revealed, the more firms will depend on assumptions about ‘average’ consumers or the aggregate properties of a block. The more information is revealed, the more it opens the possibility that different blocks will receive different levels of bidding and therefore different end prices. The involved nature of these issues mean that any auction should be designed in close consultation with the industry, academia and, crucially, legal/technical experts.

Another issue related to firms’ bidding strategies is how to treat bids that appear loss making over a single year? If the auction process covered tariffs that last only a single year, but subsequent collective switches only involve households who have not switched for three years and consumer movements resulting from a collective switch are counted as switches, bidding a below cost tariff into the collective switch could be a profitable strategy for firms. Since a collective switch utilising a disengaged consumer database would involve only consumers that had demonstrated a consistent lack of switching, firms could be confident that after the expiry of the one year collective switch tariff the consumers they had acquired would have a high likelihood of remaining with them for a further two years. A firm could recoup its losses on the one-year collective switch ‘teaser’ tariff with high prices in the subsequent two years until the consumer was again eligible for another collective switch. This scenario raises further questions: After a collective switch deal ends, should there be restrictions on the subsequent tariffs that consumers receive? Should eligibility for entry into the collective switches be synchronised with the length of the tariffs in the auction? In other words, if eligibility for a collective switch is three years without switching, should the tariffs in the auction last three years? When addressing these questions it should be remembered that the answers settled upon will have a feedback on the bidding behaviour of firms in the initial collective switching auction. Broadly speaking the more stringent the controls on firms’ behaviour over the long-term the less aggressive one would expect firms’ bidding to be in the initial auction.

The above point also highlights the question of what the eligibility criteria for participation in the auction should be. While the CMA database order defines disengagement as consumers remaining on a default tariff for more than three years, the time period for this definition is in some sense arbitrary, why not 4 or 5 years as the threshold? The three year threshold appears a sensible minimum condition for defining disengagement which suggests that if the number of consumers eligible for collective switching presents significant organisational challenges, a sensible approach to rationing access to the collective switch might be for eligibility criteria requiring a higher number of years on a default tariff.
Another dimension of the eligibility issue considers which groups of disengaged consumers are to be included/excluded from the auction. For example, will consumers with smart meters be included? In principle it seems possible to hold a separate auction for smart meters, but this might lead to new questions about whether the auction design should only cover simple tariffs or more complex time of use tariffs? Also, how will consumers with debts and/or on the priority services register be dealt with? Not all members of the former group are currently able to switch, while one might be concerned about the latter group if they were encouraged into a switching process that ultimately led to them falling off the priority services register.

Lastly, it is worth considering how the running of an auction may, or may not, interact with a PPM price cap. Even if PPM consumers are excluded from the auction mechanism, does the existence of the PPM price cap impact on the running of the auction? In particular, if the outcome of an auction for non-PPM consumers involved a price above the PPM price cap, would this be acceptable or would the auction need to be re-run?

5.1 Opt-In Collective Switch

Description: Consumers will need to take a positive step, such as ticking a box, to be part of the auction. This positive step could be in addition to a requirement for positive consent for the consumer to be placed on a disengaged consumer database. It is also possible to design the process so that after the auction has been run and the price for each individual’s energy supply has been determined, there is a further opt-in required for a consumer to be switched to a new supplier. To maximise the level of participation a public information campaign and/or outreach work would be required to promote the merits of collective switching.

Advantages: The main advantage of an opt-in collective switch is that there is no risk of consumers’ autonomy being infringed, unlike with an opt-out design. Not only is this per se positive, it may also make it possible to design a simpler collective switch involving a design that is known to only work well for certain types of consumers.

The other advantage of an opt-in design is that it is closer to an ‘off-the-peg’ solution with Section 3 demonstrating that opt-in collective switches are already being run in GB, albeit on a noticeably smaller scale than the CMA’s recommendations would imply. This means that an evidence base on the performance of this type of collective switch in GB is already available for an auction organiser to assess. Also, the auction organiser could potentially outsource the running of the auction to a third party consultancy, such as iChoosr.

Disadvantages: The main disadvantage is the need for an opt-in represents a requirement for a positive form of engagement by a group of consumers that has demonstrated persistent non-engagement over a prolonged time period. The empirical evidence presented in Section 3 makes it clear that the participation rate for an opt-in auction is likely to be considerably below that for an opt-out auction, with the evidence presented by Littlechild (2008) suggesting that the participation rate could be below 10%. While the decision not to opt in by a consumer clearly increases the likelihood that they are satisfied with their existing supplier it does not guarantee it and, as such, an opt-in collective switch is possibly only a partial solution to disengaged consumers on default tariffs. Moreover, the CMA’s findings regarding the characteristics of engaged vs disengaged energy consumers suggest that consumers who are less active are skewed towards social groups that tend to be positively correlated with common proxies for vulnerability.

That consumers must take a positive action to opt in means that to achieve a reasonable participation rate there may need to be larger marketing efforts than for an opt-out collective switch. The
experience of DECC’s Cheaper Energy Together fund presented in Section 3 suggests beyond advertising, resource intensive outreach efforts may be required if the aim is to engage vulnerable members of society. The resource required to encourage consumers to opt in is seen as the major reason for US municipal aggregation schemes adopting an opt-out structure.

If an opt-in is required to accept an offer after the auction has been held, there is no guarantee that the individuals that have opted-in to the auction will also opt-in to switch. The evidence in Section 3 appears to suggest that even among consumers that have opted-in to collective switching schemes the percentage of participants who subsequently switch appears to have an upper bound of around 25%, while many opt-in collective switches achieve switching rates among participants of only 10-15%. That switching is no means certain among collective switch participants raises the question of what happens to participants who did not switch. An opt-in collective switch can be thought of as activating the most engaged among the group of disengaged consumers to switch, leaving the average level of disengagement among the remaining group of consumers who did not switch higher than before the collective switch took place. In other words, consumers’ behaviour in the collective switch will provide firms with additional information about the relative stickiness of consumers and a rational firm may well choose to increase prices to those who did not switch. Lastly, if an opt-in is required to complete a switch after the auction has occurred, firms may be less willing to bid as the final size and composition of the block of consumers they will be bidding for will be uncertain.

5.2 Opt-Out Collective Switch

Description: Consumers will be included in the auction unless they take an action to explicitly opt-out of the collective switch. As with option (a) above, it could be possible to have two separate opt-out decision points: one to participate in the database and one to participate in the auction. To ensure that all households understand the consequences of not opting out a public information campaign appears essential. Also the opt-out form would need to be sent to households multiple times to ensure that they receive and consider the mailing. Again, as with option (a) above, there could be a requirement for further consent to complete a switch, of either an opt-in or opt-out form, once consumers are provided with details of the winning offer. An alternative, or complement, to this post-auction consent requirement could be a safeguard rule that a consumer would only face the possibility of being switched if the winning deal was projected to offer a saving over a consumer’s existing tariff.

Advantages: The central attraction of an opt-out collective switch is that it directly deals with the CMA’s theory of harm that firms have unilateral market power because consumers are disengaged. It also appears more likely to deliver benefits for the bulk of disengaged consumers than an opt-in collective switch since it does not require the disengaged to take a positive action to receive the benefit of lower prices set by the auction. With more consumers being switched the aggregate consumer savings resulting from an opt-out collective switch should be much higher than for an opt-in collective switch. The far greater proportion of disengaged consumers that are probable switchers in an opt-out scheme will probably also mean that the Big-6 firms will bid more aggressively which might lead to higher average savings per consumer. Setting the default so that consumers are switched to a better deal appears to have a greater probability of success than additional efforts to ‘activate’ disengaged consumers: that the consumers on the database have been disengaged for a long period of time when various engagement activities have been attempted suggests their responsiveness to further engagement efforts is probably low.

That more consumers will participate in an opt-out than opt-in collective switch also means that far fewer consumers on the database are at risk of firms issuing them with a price increase after the collective switch separates the sticky consumers from ultra-sticky consumers. However, for those
consumers that choose to opt-out of the collective switch any price rise they experience may be higher than for consumers who in an opt-in collective switch failed to opt in. This is because opting out involves a positive action requiring effort which suggests that it is a stronger signal of a consumer wanting to remain with their existing supplier than simply failing to opt in.

Disadvantages: While an opt-out structure seems likely to deliver greater total consumer savings, these need to be traded off against larger potential disadvantages that may occur in comparison to an opt-in collective switch. First among these is that an opt-out structure involves a greater constraint on individuals’ autonomy if it is thought that consumers do not opt-out due to behavioural biases, as discussed in Section 4. This restriction on autonomy is likely to be an important reason why municipal aggregation schemes only proceed in the US after voting by citizens or their elected representatives in individual local communities.

The advantage of an opt-out structure that it should result in a far greater volume of switches also magnifies the organisational challenges of migrating consumer accounts. This migration issue means that the implementation time frame for an opt-out collective switch may be long and may be particularly costly if improvements to the industry’s systems are required to handle the volume of switching. The demands on the industry’s customer support systems will be exacerbated if a large number of consumers feel that the switch to a new supplier is ‘unexpected’. This highlights that one problem with an opt-out system is that there will always be some uncertainty about what a failure to opt-out indicates for an individual consumer: hopefully it indicates that the consumer wants to be in the collective switch, but it could be that a consumer has not received communications about the collective switch or has not engaged with them. While sending multiple communications about the collective switch and how to exercise the opt-out choice should reduce the proportion of unwilling consumers in the collective switch, it seems unlikely that the issue can be completely overcome.

Customer service pressures will be heightened further if at the point of switching, or after it, consumers feel ‘regret’ and decide that they want to switch back to their former supplier. This sense of regret or concern might be stronger among those consumers who are switched to energy firms with brands they do not recognise and which, rightly or wrongly, they trust less. Additionally, as consumers do not take a positive action to switch it may mean that in the eyes of consumers the auction organiser has a greater responsibility for the end service provided by the winning bidder. In turn, this means that the auction organiser may face greater reputational risks if it adopts an opt-out scheme and to mitigate these risks the auction organiser may need to spend additional time investigating the consequences of particular design choices.

The greater scale of switching in an opt-out scheme is also likely to mean that any upward pricing pressure on the ‘active’ section of the market will be greater than for an opt-in switch. The political challenges around price increases for active consumers may be particularly difficult if active consumers see disengaged consumers as simply being lazy. Engaged consumers may question why the auction organiser is helping consumers who have not made an effort if it has the consequence of higher prices for consumers who ‘have done the right thing’ and made the effort to search and switch.

Also, it seems particularly unlikely that an opt-out collective switch will encourage consumers to be more engaged since the whole point of an opt-out system is to reduce the need for consumer engagement to an absolute minimum. A more likely scenario, if collective switches are held on a regular basis, is that currently active consumers may rationally choose to wait to be eligible for a collective switch due to the reduction in effort required. While by itself this may not be a problem if consumers prefer the collective switch approach, it could be an issue if it makes consumers less responsive to energy market prompts in general. In particular, this might raise concerns if it is
considered important that consumers will respond to the increased information/pricing signals of smart meters.

**Issues:** The main additional issue with an opt-out collective switch is that there is the need to carefully design the opt-out process and the communication that occurs alongside this process. The importance of the opt-out design will be heightened if an opt-out collective switch is pursued in the absence of clear democratic support or the public debate that achieving democratic support is likely to require. Equally the structuring of opt-out messages for municipal aggregation schemes in the US may provide some guidance. An interesting question when designing the opt-out is whether communications should be designed to maximise switching or to minimise the risk of harm? In other words, how prominently should any risks associated with the collective switching process be highlighted? The extent to which any risks need to be highlighted will be linked to decisions about whether, after the auction has been held, consumers will be given another opportunity to opt out (or be required to opt in) before they are switched.

As discussed in Section 3 there are also choices to be made about the ability of consumers to opt out of the winning collective switch deal after they have been switched to a new supplier. It seems desirable that consumers should always be able to opt out for a fee, the issue is whether there should be periods when consumers can opt-out without paying a fee. There is potentially a trade-off between the extent of communication efforts surrounding the opt-out process before the collective switch auction is held and the frequency with which fee-free opt-outs are offered after switches have taken place. Reduced opportunities for fee free opt-outs post-switching would seem to imply greater communication efforts are required around the opt-out process pre-switching. The need to provide periods for fee free opt-outs may be naturally solved if the term of the winning collective switching tariff is short, for example one year, and/or collective switches with the associated opportunity to opt out are held at regular intervals.

Another issue with opt-out collective switching is that for the restriction on autonomy implied by the opt-out mechanism to be minimised, the options available to consumers when they exercise their right to opt out must varied and attractive. This condition appears to be met currently by the wide range of options available to consumers in the ‘active’ section of the retail energy market. The key question is whether over the long-run, if repeated collective switches are held, the pool of active consumers will be large enough to sustain a diverse range of offers for those who choose to opt out? If very few households opt out and over the long-run currently active consumers decide that an infrequent collective switch presents an attractive alternative to annual engagement by themselves, the viability of the pool of attractive outside offers may be brought into doubt.

### 5.2.1 One-off or infrequent auction

**Description:** Here the focus would be on dealing with the ‘stock’ of customers who on day 1 of the database have been on a default tariff for more than three years. While the auction might still involve multiple rounds for different ‘blocks’ of consumers, these rounds would occur in a very short space of time, e.g. on a single day, and to the public the auction would be publicised as single large event. If it is felt that consumers will become ‘switched on’ to the energy market through the collective switching process the auction could be a one-off. In the more likely scenario of consumer disengagement persisting, a large auction event could be held once every three years (or other suitably long time period). At each auction event the aim would be to auction the right to supply the ‘stock’ of consumers who had passed the disengagement threshold. Before each auction was held there would be a new process to obtain consent from the relevant disengaged households to take part in the auction process.
Advantages: The main advantage of holding a one-off or infrequent auction (perhaps once every three years) is that the marketing of the collective switch may be easier/more effective as it can be portrayed as a large ‘event’ which consumers need to pay particular attention to. Similarly, compared to ongoing auctions, it may be more plausible to co-ordinate the marketing efforts of multiple organisations and actors into a single coherent message. More effective marketing should hopefully mean that a greater proportion of consumers make an informed decision about whether to take part or not. Indeed, a very large marketing effort might encourage general switching by consumers independent of the collective switch, especially if the prospect of being included in the collective switch is something they dislike.

The other possible advantage of infrequent auction events is that it may reduce risk of gaming or collusion by firms, although, this will depend on the particular auction mechanism chosen.

Disadvantages: The main disadvantage of holding a single collective switch is that it seems highly unlikely that it will permanently resolve the issue of consumer disengagement. If consumer disengagement is not resolved, it seems clear that the initial conditions warranting the establishment of a collective switch will remain and further collective switches would be justified. The only counter to this argument of multiple collective switches being required is if an additional event, such as the arrival of smart meters, is expected to transform the level of consumer engagement, although, whether smart meters are likely to achieve the required step-change appears questionable.

The other disadvantage of large infrequent auctions is that they imply particularly large volumes of consumers being switched in a short space of time. The greater the number of switches implied by the collective switch over and above normal switching volumes the greater the pressure on industry systems. In turn this implies costly investments may be required to provide ‘surge’ capacity and/or greater risks of systems collapsing and consumers being dissatisfied.

Issues: One issue with running large infrequent auctions is the possibility of increased consequences if a large existing player failed to win any blocks in the auction. While such an occurrence would be bad for the individual firm involved (unless it was part of a conscious strategy), it is unclear how serious this issue would be for other organisations and consumers. Firstly, it seems a relatively unlikely outcome and, secondly, the continued demand for energy and the option of wholesale trading suggests it should only threaten the viability of the retail division of a vertically integrated firm. Also, for retail consumers mechanisms already exist to ensure that they would continue to receive an energy supply in the event of a firm’s failure.

5.2.2 Frequent rolling auction process

Description: Two types of frequent rolling auctions can be conceived: (1) sequentially auctioning blocks of the ‘stock’ of disengaged consumers at weekly or monthly intervals, and (2) monthly auctions of the ‘flow’ of disengaged consumers that reach the three years on a default tariff threshold each month. If there are frequent rolling auctions, an immediate issue is how to turn the large initial stock of disengaged consumers into a relatively even flow through time. Option (1) provides a mechanism to do this with consumers potentially being placed in each block at random. Under option (2) the number of consumers reaching the three year threshold in a given month may be sufficiently low that the monthly auction may not require multiple blocks to enable small firms to bid. Also, if option (1) appears undesirable, it would be possible to combine monthly auctions to deal with the flow of disengaged consumers with a large auction at infrequent intervals, say once every three years, to deal with the pre-existing stock of disengaged consumers on an ongoing basis. While there would be a rolling sequence of auctions, opting out once or failing to opt in once would be sufficient for the consumer not to be approached for a set period of time, for example at least one year.
**Advantages:** The main advantage of running frequent auctions, especially if the initial large stock of disengaged consumers can be broken down into small tranches, is that the challenges of a mass migration of consumers between suppliers at a single point in time are reduced. It may be that the operational challenges of mass switching are so large, that holding auctions for different tranches of the stock of disengaged consumers at widely separated points in time is the only plausible option. The other advantage of holding auctions in this manner is that it manages the risk of unexpected outcomes or things going wrong in the first auction. While problems in the initial auction would still be a significant issue, holding multiple auctions would provide an opportunity for learning by the auction organiser and the potential to modify the auction design over time.

**Disadvantages:** One disadvantage of holding multiple auctions through time is that it is not just the auction organiser that has the opportunity to learn about the auction process, firms may also learn, including in ways that might be considered detrimental to consumers’ interests. Secondly, if multiple auctions are run through time it suggests the running costs of the auction process, as opposed to the switching process, will be higher. Lastly, there could well be challenges from consumers if the prices offered to otherwise identical consumers between each set of auctions vary significantly. This risk appears to grow the greater the time period between individual auctions. Even if the price differences are justified due to market changes that have occurred between auctions, this is unlikely to mollify consumer concerns. While the price difference itself may be justified, it may be difficult for the auction organiser to justify why an individual consumer is being placed in an auction at one point in time compared to another point in time.

**Issues:** If frequent auctions are being held as a means to break the stock of disengaged consumers into manageable chunks, the central issue, beyond setting the interval between auctions, is how to determine into which auction a consumer is placed. Given the likely variability in winning prices between auctions and the potentially unpredictable nature of this variability, a random allocation of consumers between rounds might be sensible. However, if dealing with the initial stock of disengaged consumers is expected to take a prolonged period of time there might be some justification for individuals in weak economic positions, or those who have not switched for the longest time period, to be the focus of early auctions on the basis that they have the greatest need from the savings that should result from the auction process.

Instead, if frequent auctions are being held on a monthly basis to deal with the flow of consumers hitting the threshold of three years on the default tariff, the main issue is if the size and composition of this flow varies significantly between months. If the block of consumers varies noticeably, and bidders have sufficient information to understand changes in the composition of consumers being auctioned, one would expect the bidding behaviour of firms to vary between auctions. These variations in bidding behaviour would be expected to increase the magnitude of price differences between auctions. If a decreasing ‘clock’ mechanism is chosen for the auction, the scheme organiser would need to be careful to avoid scenarios where the consumers being auctioned attracted few bidders relative to number of blocks being auctioned as this would appear to offer greater opportunities for gaming and possibly consumers receiving a particularly high price.

### 5.3 A note on SMEs and microbusinesses

A separate collective switch could be designed for microbusinesses and SMEs, but might be more challenging and less appropriate than one for private households. The challenge arises from the greater variety in energy requirements of SMEs and microbusinesses. For example, a craft business involving pottery, glass or ironwork may well have energy requirements that vastly exceed those of a consultancy business based in a person’s home office. Such variations may make it harder to form
uniform blocks of consumers, and it is less obvious that a uniform energy price is appropriate or fair for businesses in very different sectors.

Secondly, if collective switching and buyer power are thought to be important for small businesses, it is unclear why their trade associations do not have the capacity to organise the collective switch themselves? For trades with intrinsically high energy consumption the collective purchasing of energy would appear to be an obvious beneficial activity.

Thirdly, the CMA is clear that the retail market for SMEs and microbusinesses is far less developed than that for individual households, with the opacity of energy tariffs and resulting lack of PCWs being considered a particularly serious feature. This suggests that other remedies, such as improving tariff information should be instigated before implementing an intervention as significant as a collective switch (particularly of an opt-out nature). Such information remedies also avoid the operational complexities and costs of collective switching. These organisational complexities may be a particular risk for SMEs and microbusinesses as small enterprises often experience cashflow challenges which might be exacerbated by an unexpectedly high bill following a switch in energy suppliers.
6. Conclusions on Collective Switching

Collective switching is a form of delegated decision making where the consumer, either consciously or through inactivity, delegates all or part of the switching decision to a third party. Other delegated decision schemes include: a third party using a Price Comparison Website to switch individuals; and a third party offering to monitor and optimise a consumer’s contracts. We identify the essence of a collective switch to be the buyer power of consumers to extract from the suppliers offers for the participants which would not otherwise be available.

Evidence from collective switches presents a range of outcomes, and a sharp difference in participation between those which require participants to opt in and those based on an opt out principle. Experiences differ widely, both in terms of participation and in the benefits of offers available, with designs often depending both on regulatory structure and local democracy. As expected, schemes which require consumers to opt in have much lower participation rates than opt-out schemes, but the switching rate among participants is generally higher where consumers have already made a conscious step to take part. Even so, switching rates are surprisingly low, even where positive steps are required to participate and there are low barriers to switching once the offer is presented. Given the inactive (recent) history of those on a Disengaged Consumer Database, the evidence suggests that relatively low numbers would opt into such an exercise either to enter the auction or accept the offer. If the concern is to involve such consumers in the benefits of competition, the most effective way would be through auctions where the default is to be included and consumers have various opportunities to opt out. The merits of opt-in and opt-out mechanisms depend on whether the objective is to involve consumers in a direct way (in which case opt-in delivers better engagement) or to deliver the best possible outcome in terms of energy cost reductions for the greatest number (for which opt-out may deliver more benefits). In either case the distribution of benefits and costs across households may be salient to the decision makers.

The appropriateness of opt-out collective switches depends partly in interpreting the inaction of disengaged consumers. If inaction is due to satisfaction with the energy market, opt-out schemes might seem excessively interventionist. However, if inaction is due to biases of some description or the costs of engaging with the market, an opt-out auction might provide a ‘minimalist’ default intervention consistent with ‘liberal paternalism’. The principles of opt-in and opt-out mechanisms in a broader context have been discussed in Section 4, which relates both their design and observations from experience to the literature on behavioural economics. In particular, the design of defaults has been shown to affect how many and which consumers will be included in an auction. The substantial differences between participation in opt-in and opt-out schemes reported in section 3 are explained by these concepts.

In terms of designing a collective switching mechanism, we have observed the following three basic models: the organiser of the mechanism procures offers from existing retailers and acts as an agent (e.g. TBS); the organiser of the mechanism buys and resell energy, acting as a retailer (e.g. Single Buyer); or the organiser of the mechanism buys wholesale and sells through the regular retailer (e.g. New Jersey).

Where an auction is used, we find a great variety in both design and criteria for participation. These include:

- Auction only applying to the wholesale component of the bill
- Further opt-in/opt-out to complete a switch after receipt of an offer
- Automatic switching when the winning offer exceeds a specified saving figure
• Outreach work to boost participation by vulnerable groups
• The length of time for which the winning deal lasts
• The ability to opt into/opt out of winning deal during the life of the deal
• A safeguard mechanism (e.g. is the winning deal actually the cheapest?)
• A safeguard for particular consumers, particularly in opt-out schemes
• The size of blocks and the bundling of consumers
• The frequency of repeating the auction process

Evaluating collective switching mechanisms based on auctions, we find that the main advantages are that they can be a powerful mechanism to create competitive pressure and that the collective nature of the mechanism reduces search and switching costs for consumers. The disadvantages are that there is a cost to designing and running an auction, there is a cost of switching a large fraction of consumers in a short space of time, there is a risk of errors in a large mechanism and, finally, there are likely to be external effects on other sections of the market involving ‘active’ consumers (and potentially other markets).

An issue which has ambiguous effects is the potential to create welfare maximising bundles of consumers. This may increase overall welfare as the gain from valuable bundles attracts keen bids which may potentially exceed the losses from the less valuable bundles. This comes with a (political) cost that different groups will be treated differently and while discrimination can increase overall welfare, it also creates winners and losers.

In terms of using a collective switch with a disengaged consumer database, as noted above, to achieve a high participation rate it is necessary for the collective switch to be opt-out in nature. This need for an opt-out mechanism creates many of the challenges for implementation. First, an opt-out mechanism may create legal issues around the strength of consent obtained from consumers. These potential issues, the challenges of public acceptability and the general landscape of data protection law that a disengaged consumer database would have to comply with are explored in Appendix B. Additionally, as seen in US states, the fact that an opt-out mechanism retains a degree of compulsion may suggest that active democratic/political approval for such a mechanism could be an advisable precursor to implementation.

Second, an opt-out mechanism, by substantially increasing participation, leads to the implementation challenge of switching a larger number of retail consumers in a short space of time. Here there appears to be a trade-off: creating a greater number of smaller blocks of consumers auctioned at different points in time eases the operational challenge, but increases the probability that otherwise identical consumers are charged different prices. Since a key element of the CMA Energy Market Investigation and the politics of the energy market concerns price differentials between consumers, the latter appears undesirable. While further research will be needed before any auction design is chosen, in Section 5 we explain that a ‘falling’ clock auction has the attractiveness that within a single auction all blocks of consumers will receive the same price.

Third, if the auction works as intended such that it introduces significant competitive pressure where it was previously lacking, this is likely to have wider implications for the retail energy market. The extent of the impact on prices in the currently ‘active’ segment of the market will depend on whether the CMA is correct in its analysis that the current price differential between ‘inactive’ and ‘active’ consumers is due to unilateral market power allowing excess profits/inefficiency. If the CMA is correct, any upward pressure on prices in the active segment of the market should be small, however, if the currently higher prices for inactive consumers reflect the allocation of fixed costs to this group, a successful auction could lead to a reallocation of fixed costs resulting in upward pressure on the prices
charged to currently active consumers. In turn, the presence of the auction mechanism as a fallback for inactive consumers may reduce the incentive for currently active consumers to remain engaged with the energy market.

Fourth, and finally, the introduction of an opt-out collective switch for disengaged consumers is unlikely to increase engagement by consumers over the long-run: the explicit reason why such a mechanism may prove effective is that it removes the need for active engagement by consumers. The implication of this is that any auction is likely to need to be repeated once every few years rather than a one-off event which resets the market. While this means that the costs of repeated auctions need to be accounted for, the lack of increased engagement is not necessarily a problem if the auction is successful in delivering competitive deals to consumers which are close to cost. Arguably consumer engagement is merely an intermediate objective, rather than an end objective such as low prices or high quality, so if an alternative mechanism, such as an opt-out auction, is able to deliver the end objectives without requiring consumer engagement this is not automatically a problem.

Recognising that there are trade-offs and issues with an opt-out collective switch, in Appendix A possible alternative uses for a disengaged consumer database are explored. Since Appendix A is intended to represent ‘blue sky thinking’, options are included that have obvious issues arguing against their adoption.
7. References


Laufer, J., B. MacDonald, B. Pike and M. Zhou (2013), ‘Community Choice Aggregation: Municipal Bulk Buying of Electricity in Massachusetts’, report prepared for the Metropolitan Area Planning Council, the City of Medford and GridSmart Energy


Appendix A - Other Database Options

We now explore other options for a Disengaged Consumer Database beyond using it for collective switching. The following options represent ‘blue sky thinking’ and, as such, the inclusion of a particular option does not represent an endorsement of the option’s use; we include options that appear to have serious weaknesses. The discussion aims to explore the advantages, disadvantages and issues with all the potential uses of a database that were identified by the research team. While each option has its individual merits assessed, it should be remembered that many of the options are not mutually exclusive and could be used in combination with each other. Also, we caution that the number advantages and disadvantages for each option should not be used as a shorthand to assess the relative attractiveness of each option since the arguments highlighted by each bullet point differ in their importance. Furthermore the advantages and disadvantages are best interpreted as our intuitive understanding of the core issues, rather than statements of fact for which we have solid evidence. Finally in this appendix we do not comment on the legal issues described in Appendix B. Appendix B indicates that for a number of the options below it would be very challenging for them to pass a test for legality.

As explained at the start of Section 5 the discussion is presented in hierarchy of design options with 7 high-level uses of the database, beyond collective switching being identified. A summary of the hierarchy is provided below:

1. Hold an auction for the right to access a disengaged consumer database
   a. Database of contact details only
   b. Database of contact and consumption details
2. Provide access to the database to third party organisations for free
   a. Access to ‘Not for Profit’ organisations
      i. Local authorities
      ii. Citizens Advice
      iii. Specific Charities (perhaps Vulnerability related)
   b. Access to ‘Profit Making’ organisations
      i. All energy firms
      ii. Small energy firms
      iii. ‘Good’ energy firms
      iv. PCWs/Third Party Intermediaries
      v. Firms wanting to run experiments
3. Link database to government data
   a. Link to social security data
   b. Link to health data
   c. Use data to establish a state supplier for ‘worthy’ households
4. Use by a Market Regulator
   a. For ‘official’ communications to customers
   b. For ‘official’ communications containing PCW-type information
   c. For conducting experiments
5. Provide personalised support services to consumers on the database
   a. Comprehensive general financial advice
   b. Energy only advice on switching
   c. Provision of energy efficiency investments
6. Targeted Price Regulation for disengaged consumers
7. Do not use/create a database
   a. Relabel SVTs with something emotive
   b. Require firms to perform additional activities in relation to disengaged consumers

1. Auction access to the database

Description: An auction would be held with the winning bidder(s) being given the exclusive right to send marketing communications to the block of consumers for which they had won the auction. The number of blocks and terms of the auction would be designed to maximise the revenue from the auction. Existing incumbent firms would be allowed to bid with it being expected that they would be among the firms entering the highest bids as they have the deepest financial resources and are likely to have a strong incentive to stop rival firms being able to access their default tariff customers. One would hope that the revenue achieved from the auction would approximate the expected profit that firms could obtain from being able to contact the consumers. Firms would be free to recover the cost of purchasing the data from consumers. Also, to maximise the value of data there would be no restrictions on the marketing communications that firms could send beyond the constraints of standard consumer protection rules. The revenue from the auction for each block would be distributed among the disengaged consumers within the block as a lump sum payment. This lump sum payment would at least partly offset the higher prices that default tariff consumers are charged. Variants could involve the auction revenue being used to finance outreach work to encourage switching among particular disadvantaged/vulnerable groups or the installation of energy efficiency devices.

Advantages:
- The winning bidder will have the maximum value for the data which may mean the auction selects the firm with the greatest ability to encourage switching
- The winning bidder has an ongoing incentive to maximise/optimise data use and so hopefully will maximise switching
- Generates revenue that could be redistributed to disengaged consumers or be used to finance other interventions

Disadvantages:
- The winning bidder will have to recoup the cost of the data by charging consumers
- The idea of selling data is likely to be unpopular among consumers
- There is no guarantee that the winning bidder will be the ‘best’ for consumers
- The greater financial resources of the big-6 might mean entrants are guaranteed to lose
- The winning bidder with the maximum value for the data could be one of the Big-6 who wants to stop rather than encourage switching

Issues:
- Should there be a single winner or multiple winners?
- If a single winner, does database access give the winner excessive market power?
- Are restrictions placed on the data’s resale?

   a. Contact details only

Description: No information on consumption details would be provided, just sufficient information for marketing communications to be possible.

Advantages:
- Limits the possibility of additional price discrimination
Disadvantages:
- Does this data have any meaningful value?

Issues:
- How different is this data to that which can already be purchased?

b. Contact and consumption details
Description: Alongside the consumers’ contact details, information would be provided regarding consumers energy usage. This consumption data could be provided at the finest granularity available, i.e. if a consumer has a smart meter, the data could include their daily consumption patterns.

Advantages:
- The data is more unique and so is likely to have more value
- Making a large block of consumption data available may encourage new product offerings/stimulate innovation

Disadvantages:
- Extra data will allow more precise price discrimination
- Consumption information may mean firms target only a sub-section of the disengaged

Issues:
- Is existing consumption data of sufficient quality and available in a common format to enable its sale?
- Does Midata mean firms will receive the necessary consumption data in the near future? In other words, does Midata reduce the commercial value of a database?
- Should consumers have a choice regarding whether their consumption data is included in the database?

2. Provide free access to the database
Description: Access to the database is provided for free to organisations selected by the database organiser. Database access could be provided on an ongoing basis or for only a temporary period. There could be restrictions on the total quantity of marketing material sent or on the number of organisations able to engage with any individual consumer. The free access could be used to send out marketing to encourage switching, to conduct experiments or to provide other energy related support services.

Advantages:
- Potentially allows all firms/parties equal access to the data
- The absence of an upfront cost to access the data may encourage innovation/experimentation
- The large number of organisations accessing the data should maximise experimentation/innovation
- It may encourage existing providers to reduce prices for their disengaged customers so as to manage the risk of increased switching
- By getting consumers to switch once, consumers may learn that switching is easier than they thought thereby having a long term impact on engagement.

Disadvantages:
- Potentially a lost revenue opportunity
- If there is a big increase in switching, it may mean fixed costs need to be recovered from other consumers i.e. prices for ‘active’ consumers might increase.
- If the intervention activates some consumers, the average ‘stickiness’ of the remaining disengaged consumers will have increased and so price discrimination might imply they are charged a higher price.
- A consumer engaging with the energy market imposes an opportunity cost on the consumer, the more consumers who engage/search/switch, the higher these costs.

Issues:
- Do incumbents increase the volume of their customer communications/junk mail so the communications of rivals have less impact?
- Do the organisations to which the data could be given really want the data/have concrete plans for it? Would understanding these plans help the database organiser’s decision making?

(a) Not for profit

Description: The data would be provided to organisations that have a ‘social’ purpose other than profit making. The aim would be to enable engagement by organisations that can provide ‘neutral’ advice and which might be highly trusted by particular social groups. Thought would need to be given to how to manage access by not for profit organisations with commercial arms or those that partner with commercial organisations.

Advantages:
- Possibly greater customer comfort with data being shared
- Potentially helps a new group of organisations enter the energy market
- The ‘trusted’ nature of certain not for profit organisations may mean consumers take more notice of their communications
- Absence of the profit motive may allow the neutral identification of the best option for a consumer

Advantage or Disadvantage:
- Limited availability of funds for not for profit organisations may limit the quantity of customer communications

Disadvantages:
- Not all organisations will have good knowledge of the energy market
- Energy firms may query why they are not being allowed access
- Absence of the profit motive may dull incentives to promote switching
- The profit motive may just be hidden rather than removed with not for profit organisations relying on profit-making consultancies/PCWs to run the service

Issues:
- Are all not for profit organisations equally trustworthy/suitable?
- Should not for profits be limited in their ability to ‘endorse’ products/services from profit making energy firms?

(i) Local Authorities

Description: Local authorities would be given access to information concerning disengaged consumers in their locality. Each local authority would have the freedom to choose what to do with the data thereby supporting experimentation. Given that local authorities provide social care and may still own social housing, they could also be given the right to link the database with their own data to provide a more integrated support service for their clients. Alternatively, database access may enable local authorities to better target their marketing and outreach work regarding the collective switching exercises that are already being run in their name.
Advantages:
- Already in contact with individuals in their area
- Will have some information on households which are ‘vulnerable’
- Where a household is in social housing there might be scope for integrated interventions e.g. improving energy efficiency
- Some local authorities are already setting up/discussing their own energy firms
- Since households have only one local authority the volume of mail will be limited

Disadvantages:
- Since households have only one local authority the limited quantity of consumer contact may limit switching
- Do all local authorities have sufficient skills/buyer power to get good energy deals?
- Potentially leads to ‘postcode lotteries’ as prices and quality of service vary by local authority area

Issues:
- Do local authorities want responsibility for energy choices?
- Will local authorities be able to link the database to other data they already hold?

(ii) Citizens Advice

Description: Citizens Advice alone, or in conjunction with other organisations, is given access to the database. Citizens Advice could utilise the database in conjunction with its ‘whole of market’ price comparison tool to offer details of the cheapest energy supplier on the market to disengaged consumers. Since the database includes consumption details, obtaining a cheapest quote should require less effort from a consumer than if a disengaged consumer independently used Citizens Advice’s price comparison tool. The service could be reactive, i.e. only involving consumers who contact Citizens Advice, or proactive with Citizens Advice contacting all disengaged consumers, although, this latter option would presumably require additional resources to be provided to Citizens Advice.

Advantages:
- An organisation that consumers should trust
- Conducts existing work in the energy market space
- Extensive experience of dealing with the vulnerable
- Might be in a good position to offer broader ‘financial counselling’
- Could be linked to the outputs of Citizens Advi\-ces’ ‘whole of market’ PCW

Disadvantages:
- A reputation for dealing with the vulnerable/those with a problem might put off ‘average’ consumers?
- Giving data to a single organisation limits the potential for experimentation
- Limited pro-active capabilities? In other words, is the Citizens Advice model more about individuals approaching Citizens Advice rather than Citizens Advice reaching out?

Issues:
- Will Citizens Advice receive additional funds to match its new responsibilities?

96 A marketing campaign could increase the likely rate of contact under this option.
(iii) Specific Charities (perhaps Vulnerability related)

**Description:** Given the large number of charities that exist, the database organiser would select only those charities providing a persuasive case that they could utilise the database in a meaningful way to the benefit of energy consumers. Charities could use the database to provide energy-related support services, to encourage switching or to market deals from commercial suppliers which the charities feel represent good deals. The effectiveness of charities’ communications is likely to be greatest when they can target the section of disengaged consumers to whom they are most relevant, e.g. AgeUK targeting pensioners. The ability of charities to provide targeted marketing will be closely linked to the availability of demographic and/or socio-economic information in the database.

**Advantages:**
- Likely high level of trust and visibility among particular groups

**Disadvantages:**
- What about ‘average’ non-vulnerable consumers who are disengaged
- Different (vulnerable) groups may achieve different outcomes based on the effectiveness of their affiliated charity(ies)
- Reputational risk to charities of being linked to the energy market and things going wrong, which might deter their involvement
- Do all charities have sufficient skills/bargaining power to identify/obtain good energy deals?
- Do letters/contact from charities really engage consumers given the quantity of junk mail charities send?
- Is there the possibility of confused roles/conflicts of interest if a charity recommends a particular profit making energy firm?

**Issues:**
- How many charities should be allowed access to the data?
- What criteria should be used to select charities that can contact consumers?

(b) For profit

**Description:** Database access will be provided to commercial organisations such as energy firms, firms in other sectors and price comparison websites/third party intermediaries who seek to utilise the database for profit making purposes. These profit making purposes will exclude the resale of the data to other organisations and for purposes that are not energy related.

**Advantages:**
- The profit motive encourages effective communications that maximise switching/engagement
- Follows the CMA’s proposals closely
- Firms’ existing knowledge of the market may mean they are best placed to determine how to use the data for maximum benefit/to maximise switching

**Disadvantages:**
- The profit motive may lead firms to highlight the most profitable rather than the cheapest/most suitable deals to consumers
- The profit motive is likely to encourage firms to use the data to further price discrimination if possible
- The profit motive may encourage re-selling of the data

**Issues:**
Does providing the data for free create any issues re: state aid? Especially, if the data is only given to a subset of firms?

(i) All Energy Firms
Description: All energy firms would have equal access to the database for marketing purposes. Rules may be put in place to limit the quantity of marketing communications being received by any individual household. These rules could involve: (1) limiting the calendar time period when communications can take place; (2) limiting the number of communications per firm; (3) setting a maximum number of firms that can communicate with an individual consumer; and/or (4) randomly allocating the right to communicate to a certain block of consumers to particular firms. With option (3) firms would be able to access consumers on a ‘first come first served’ basis until the total number of permitted communications had been reached. With option (4) all firms would have the right to contact the same number of consumers, with the individual consumers forming their allocation being randomly selected. Each block of consumers could be allocated to multiple firms or to a single firm. All efforts to limit the quantity of communication would require a properly resourced monitoring system.

Advantages:
- Maximises the range of offers and the amount of contact with customers
- Allowing all firms equal access to the data avoids the risk of excluded firms challenging the process

Disadvantages:
- Risks a deluge of junk mail
- No certainty that the first offer/the offer accepted by a consumer will be the best/a good deal
- Maximises opportunities for the Big-6 to engage in behaviours that have the effect of deterring switching

Issues:
- If customers’ existing provider(s) are revealed, does it assist tacit collusion i.e. it enables other firms to understand who not to target?

(ii) Small Energy Firms
Description: Access to the database by the ‘Big-6’ would not be permitted. This option is explicitly designed to encourage non-incumbent firms to market their products to disengaged consumers on the basis that they have a greater incentive to encourage switching and supporting smaller firms might boost competition to a particularly large extent. How small is ‘small’ would have to be determined with a decision taken as to whether to include/exclude mid-tier suppliers. Since there are a large number of small energy firms it is likely that some limits on the quantity of marketing communications as outlined for option (ii) above would be required.

Advantages:
- Reduces the risk of Big-6 engaging in behaviours that limit the intervention’s effectiveness
- It could help small firms/new entrants on their way to become serious challengers to the Big-6
- It could provide the large number of customers that enable a new business model to reach the scale it needs to succeed.
- Potentially reduces the marketing costs of small firms

Disadvantages:
- Could this be seen as a subsidy to small firms? Is this beneficial?
- No guarantee that ‘small’ firms are ‘good’ firms
- Do all small energy firms have the capacity to rapidly take on a large number of customers?

**Issues:**
- What would be the criteria for a ‘small’ firm? Simply not one of the Big-6 or something more?

**(iii) ‘Good’ energy firms**

**Description:** Access to the database would be restricted to those firms considered ‘Good’ by the database organiser. In this option the definition of ‘Good’ is assumed to imply a meaningful restriction on the number of firms able to access the database rather than simply being minimal requirements covering data protection issues. As the central concern is that consumers on default tariffs suffer high prices, it seems sensible that ‘Good’ is defined in relation to having a low price subject to minimum service ‘quality’ standards being met. It could be that the N firms with the lowest prices can access the database or those firms within X percent of the lowest price could access the database. A simple mechanism might select firms on the basis of providing the cheapest bill amount for an average level of consumption. A better system offering less opportunity for gaming and better matched results for consumers would involve the cheapest firms being identified separately for each individual consumer and each firm only being able to contact those consumers for whom the firm fell into the cheapest group. An alternative or complimentary ranking to identify ‘Good’ firms could involve metrics based on firms’ customer service performance or ‘green’ credentials.

An alternative arrangement could be that all firms will ultimately have access to the database, but the ranking of firms would be linked to exclusive periods when they could contact consumers. For example, in the first month only the best firm would have the right to send communications, while in the second month the top 2 firms could send communications, while in the third month the top 3 firms could send communications etc. The primary issues with this alternative approach appear to be: (i) the organisation and monitoring could be complex, and (ii) what happens if the ranking of firms changes after a couple of months?

**Advantages:**
- Creates an incentive for firms to behave in a ‘good’ fashion
- Limits the risk of consumers switching to ‘bad’ deals

**Disadvantages:**
- Likely to be challenged by firms who are not able to use the database
- Among the pool of ‘good’ firms there is no guarantee that a consumer will receive the communications from the best firm first
- If ‘good’ firms are to be judged by price, the database organiser needs to establish/purchase a PCW-like function. This has costs and raises the question of why the PCW is not provided to all consumers.
- Possible pressure to identify ‘good’ firms on the basis of criteria that not everyone agrees with e.g. green/ethical stance
- Once a firm has initially been identified as ‘good’, does it create a challenging event to manage if a firm has to be delisted for no longer being ‘good’?

**Issues:**
- If firms are ranked by price, but communications are by mail how are the time lags between the ranking being made and a consumer responding to the communication dealt with? Is there a risk that the ranking changes or good deals are ‘pulled’ before a consumer can access them?
- Are firms identified as being good for all consumers? Or are different firms identified as being good for different groups of consumers?
- What are the criteria for a firm to be judged as ‘good’?
- Will there be a limit on the number of firms identified as ‘good’? What is the appropriate number of firms for the limit?

(iv) Price comparison websites (PCWs)/third party intermediaries

Description: Access to the database would be restricted to intermediaries who provide a comparison of different energy suppliers. By comparing a range of suppliers consumers should be sent information on the cheapest or at least relatively cheaper suppliers. This approach could harness the marketing capabilities and well-known brand names of the major PCWs. Also, it might provide a launchpad for third-party intermediaries to provide innovative services that involve continually monitoring the market on the behalf of consumers thereby addressing the issue of ongoing consumer disengagement. Assuming that the number of intermediaries is noticeably smaller than the number of energy suppliers, to control the quantity of marketing it may be sufficient simply to set a cap on the number of marketing communications per firm rather than per consumer.

Advantages:
- Consumers should be presented with deals which are good/the best on the market.
- PCWs’ incentives potentially seem aligned with the CMA’s i.e. to maximise the switching rate
- The large PCWs’ brands are well-known as the result of marketing efforts that are seen to be noteworthy/successful.
- The scheme organiser could steer people towards the Citizens Advice ‘whole of market’ PCW
- If disengaged energy consumers are disengaged in other markets, PCWs could help consumers save money in multiple markets.
- The prospect of cross-selling products beyond energy could make PCWs particularly interested in using the database.

Disadvantages:
- Is there much benefit? PCW adverts are some of the most ubiquitous on TV, will additional contact work?
- Are PCWs interested in super-sticky customers when their business model is really about attracting enthusiastic switchers repeatedly/those who occasionally switch?
- Whether PCWs identify the best deal on the market is dependent on them maintaining ‘whole of market’ coverage etc.
- If multiple PCWs send different offers to the same consumer with each labelled the best on the market as a result of different estimation methodologies, does this just result in a lot of confusion/lack of trust?
- If firms no longer have to offer ‘whole of market’ coverage, might there be an incentive to create a comparison set where none of the offers are particularly good? (the PCW does not need to provide deals appealing to savvy consumers)

(v) Firms wanting to run experiments

Description: Access to the database would only be provided for use in experiments rather than for marketing. To ensure that the experiments are not ‘marketing in disguise’ and that the experiments meet basic standards for academic credibility, all the experiments would be subject to an approval process by the database organiser. It would be expected that the results of all experiments are made
public along with the list of all experiments approved by the database organiser so that the level of abandoned experiments could be monitored. All firms would have equal access to the database and any experiment with a clear social benefit, not just those likely to promote switching, would be permitted. It would also seem sensible to open database access to organisations beyond firms, such as academic institutions. Some process might be required to ensure that different experiments do not 'clash' and to allow firms to challenge the costs of implementation where the experiments require incumbent firms to apply system changes to the treatment group of consumers. An academic panel could be established to provide peer review to the experiments and advice on the overall conduct of the scheme. There would also need to be a clear process for deciding whether the results of the experiments would be incorporated into government/regulator policy.

Advantages:
- By maximising the number of organisations generating ideas for experiments the greatest amount of innovation/knowledge should be generated
- The outcomes of the experiments could lead to better policymaking and hopefully more switching

Disadvantages:
- Firms will probably have a vested interest in the outcome of the experiments
- Firms may choose the experiments likely to give results supportive of lobbying campaigns for particular policy changes.
- The firms with customers on the database might engage in difficult to monitor activities that invalidate the results of experiments performed by other firms
- Will consumers be willing to take part in the experiments? Is their explicit consent required?
- If participants have to opt in by giving consent, does this undermine the validity of the results if the opt-in acts as a filter which self-selects those consumers which are relatively more active?

Issues:
- Can effective experiments be run if the only information available on the participants are their contact details? Is the co-operation of the customers’ existing suppliers required?
- Will there be a limit on the number/type of experiments run? If so, how will decisions be taken about which experiments are run?
- How will the scheme organiser ensure that experiments run by firms, who have a vested interest in the results, are performed in a neutral fashion?
- Will interventions designed to benefit a small subset of disengaged consumers still be trialled?
- Will there be a requirement for the results of the experiments to be made publically available and for free?
- Might extensive requirements on publically publishing the results of experiments deter firms from taking part?
- Will there be a requirement that all experiments are registered with the database organiser? (In medicine there are potentially issues of multiple experiments being run until the ‘right’ results emerge by chance.)
- Will there be a formal mechanism for the results to be fed into policymaking?
- Will there be rules about firms running experiments on their own customers in the database/restrictions on experiments run by the Big-6?
- Will there be a mechanism to ensure that the same consumers are not subjected to multiple experiments simultaneously?
- Will not for profit organisations be allowed to run experiments? They might have fewer incentive problems than firms.
- Does the firm with the disengaged consumers get notified that some of their consumers are being experimented upon?
- Does the firm with the disengaged consumers have any chance to refuse/appeal against an experiment being run on the grounds of cost/disruption?

3. Link to government data

**Description:** Access to the database would be given to central government with the explicit intention of the contact details and energy consumption information being combined with more sensitive types of data held by government. The aim would be to harness the greater detail and breadth of government data to enable new forms of support to be targeted more precisely at particular types of disengaged energy consumers. Specifically, the use of government data should hopefully enable the separation of the ‘vulnerable’ disengaged from the ‘lazy’ disengaged. The linked data could remain entirely under the control of government or be provided in a pared down form, but with suitable ‘flags’, to other relevant organisations. The increased sensitivity of the data held by government would require particularly secure handling processes for the linked data.

**Advantages:**
- Linking data brings something genuinely new to the energy market context.
- Enables the separation of the ‘vulnerable’ disengaged from the ‘lazy’ disengaged. Issues around errors of inclusion could be greatly reduced/removed.
- Opens up a whole new range of interventions that are beyond the legal/practical abilities of firms, not for profit organisations and/or a market regulator

**Disadvantages:**
- If linking only occurs after an opt-in process, is the impact of the proposal seriously weakened?
- Is primary legislation required for data linking to occur?
- May involve significant costs and the risks of failures associated with government IT projects
- Implementation is reliant on continuing government approval, if the government changes the programme might get cancelled

**Issues:**
- In which direction does the linked data flow? Do energy firms get to know about benefits and disability etc? Does the government get to know energy consumption data?
- Does it raise concerns about the scheme organiser’s independence? The organiser’s scheme would be being delivered in conjunction with the government.
- Is there ongoing linking through time as additional consumers become disengaged or is only the current stock of disengaged consumers linked?
- If a consumer switches supplier or stops receiving benefits, will their data be de-linked?

(a) Link to social security data

**Description:** Energy consumption data and contact details would be combined with data held by government on the receipt of benefits and/or disabilities. The linking of these types of data could enable resource intensive interventions to be targeted at those who have both high energy bills and low incomes or vulnerabilities. For example, it might be a sensible use of resources to ensure that all households in receipt of means tested benefits are on the cheapest possible energy deal.

**Advantages:**
- Enables energy consumers receiving benefits to be identified
- Enabling those on benefits to get cheaper energy is akin to saving the taxpayer money — either households achieve higher welfare for a given level of benefits or the adverse effects of benefits cuts can be mitigated.
- Additional assistance/special tariffs can be effectively targeted at those with the lowest ability to pay.
- Reducing the prices that low income households pay for energy could be an effective way to reduce the recorded rate of fuel poverty

- The combination of high energy bills and the receipt of benefits could be used to target energy efficiency improvements

Disadvantages:
- The monetary savings from switching energy supplier may be more uncertain than they first appear so reduced energy expenditures being used as a reason to cut benefits seems risky
- If ‘cheap’ energy was linked to certain benefits, this might act as an additional disincentive against entering work etc.

Issues:
- If energy firms had access to this linked data, might they resist supplying certain types of benefits claimant on the grounds that they are a poor credit risk?
- For fuel poverty alleviation are other types of data from different departments beyond social security required?

(b) Link to health data

Description: Energy consumption data and contact details would be combined with data identifying temperature related health conditions, disabilities and/or vulnerabilities. Health data would provide an alternative, or complementary, set of indicators to social security data in terms of identifying disengaged consumers which are ‘worthy’ of additional resource intensive assistance. For individuals with certain conditions it might prove cost effective for the government to ensure that they are on the cheapest possible energy deal or that they receive financial support sufficient that they do not limit their heating expenditure.

Advantages:
- Identifies those with a particular need for living in a warm home thereby enabling targeted assistance.
- Identifies those with particular vulnerabilities who would need additional engagement/support through the switching process. This includes providing a smooth switch for those on the priority services register.

Disadvantages:
- As this is the most sensitive type of data, the data handling safeguards might be particularly costly
- Would linking to health data provide any real benefit for the majority of disengaged households?
- Who would pay for any additional services/support targeted at the vulnerable?

Issues:
- Would the data be de-linked once any temporary vulnerability had resolved itself?

(c) Establish a state supplier for selected ‘worthy’ households

Description: Once a policymaker is in possession of sufficient information that they can separate the ‘vulnerable’ or ‘worthy’ disengaged from the ‘lazy’ disengaged it is possible to consider solutions which take the ‘vulnerable’ disengaged out of the energy market altogether. An obvious approach would be
to create a not for profit organisation or state supplier with the express purpose of providing an energy supply to the selected households with a zero profit margin. The state supplier could be little more than a branding exercise for a collective switch, i.e. the supplier would tender for existing energy retailers to supply these consumers, or it could be a somewhat more elaborate retailer that purchased energy from the wholesale market. The focus of a state supplier in this scenario would be explicitly on minimising cost rather than the promotion of other objectives such as the pursuit of green energy.

**Advantages:**
- Removing disengaged households deemed worthy of additional support from the energy market completely could be a politically stable solution
- The ‘state supplier’ could just be branding for a company winning a tender i.e. it might be little different from an opt-out collective switch
- A state supplier operating at low/zero profit could increase the political pressure on energy suppliers in the wider market by providing a benchmark for low-cost supply

**Advantage or Disadvantage:**
- A state supplier for a subset consumers could represent a credible threat to nationalise the wider energy retailing sector encouraging good performance/low prices or leading to suppliers exiting the market as their cost of capital increases.
- A state supplier would provide the capacity for a future government to end the retail energy market.

**Disadvantages:**
- Establishing a state supplier could take a significant amount of time
- Potentially controversial as akin to saying that particular groups in society are incapable of engaging with the energy market
- If the state supplier underperformed, the failure might be blamed on the government of the day
- For political reasons a government might use the state supplier to provide energy to certain groups at a price below cost.

**Issues:**
- Once supplied by the state supplier what would be the criteria for a household to return to the energy market? Would leaving the state supplier always require a householder’s agreement?
- While the stock of disengaged consumers could be carved out from the market, how would the ongoing flow of consumers who had not engaged for a prolonged period be handled?
- If a state supplier was just a glorified tendering exercise, what non-price factors, if any, would be taken into account when evaluating tenders?

**4. Database use by a market regulator**

**Description:** Only the market regulator would have access to the database, there would be no sharing of the data with other organisations other than for the implementation of market regulator led projects. A weaker alternative would be for a market regulator to utilise the database alongside other organisations of its choosing.

**Advantages:**
- The market regulator would have complete control of how the database is used
- The market regulator has greater knowledge of the energy market and its participants than local authorities and generalist charities
- A market regulator might be in a relatively good position to take decisions in a ‘neutral’ way thereby obtaining the ‘best’ outcome for consumers rather than the outcome which maximises profit/the benefits to the group served by a particular charity.
**Disadvantages:**
- The market regulator would have complete responsibility if something went wrong
- Restricting the organisations that could access the data could limit the scope for innovations
- Interventions might be limited by the financing available from a market regulator. Would the market regulator have a budget for new interventions/communications?
- If there is a big increase in switching, it may mean fixed costs need to be recovered from other consumers i.e. prices for ‘active’ consumers might increase.
- If the intervention activates some consumers, the average ‘stickiness’ of the remaining disengaged consumers will have increased so they might be charged a higher price
- A consumer engaging with the energy market imposes an opportunity cost on the consumer, the more consumers who engage/search/switch, the higher these costs.
- A market regulator might not have the full range of skills necessary to fully exploit the potential of the database.

**Issues:**
- How would a market regulator treat schemes that benefitted consumers on the database at the expense of other groups of consumers/the functioning of competition in other parts of the market?
- Will incumbents increase the volume of their customer communications/junk mail so that the intervention’s communications have less impact?
- If a known group of disengaged consumers are tenants, but for a variety of reasons they are disengaged/constrained from acting, does it make more sense to instead target interventions at landlords?

**(a) ‘Official’ communications**

**Description:** The market regulator would utilise the database to identify consumers to whom official communications would be sent. These communications would primarily be designed to encourage switching and would emphasise that the market regulator is a trusted/neutral organisation. The design of the communications could be determined following randomised control trials. Communications could also be sent on other topics such as energy efficiency or how to understand energy bills. As all database related communications would be under the control of the market regulator the number of communications reaching an individual consumer could be easily limited.

**Advantages:**
- The market regulator could completely control the content of the communications
- The market regulator could send out communications at the optimal point in time to encourage switching
- The market regulator could limit the number of new communications to avoid a deluge of junk mail
- Some consumers may trust communications from an ‘official’ source more than from private energy firms
- With communications coming from a single source there is less risk of multiple conflicting messages which lead to consumer confusion.
- A market regulator can produce communications even if a private firms feels the benefits do not outweigh the costs i.e. when positive externalities exist

**Disadvantages:**
- The profit motive provides a disciplining mechanism that means firms might think more carefully about which actions will/will not work.
- Generally it is thought that private enterprise is better at communicating with consumers than the state.
- How many disengaged consumers know who the market regulator is and, hence, will know to place particular weight on the market regulator’s communications?
- The market regulator will not be in control of communications sent to consumers by energy firms using information from sources other than the database, as a result there may still be consumer confusion.

**Issues:**
- Does a market regulator as an official body have greater legal rights/powers to send communications/use the database than private firms?

(b) ‘Official’ communications containing price comparisons

**Description:** Any communications designed to promote switching would incorporate the results of a price comparison exercise so that all disengaged consumers would be presented with the deal that was cheapest for them. As a market regulator would be in control of the comparison it could be ‘whole of market’. Being presented with an estimated personal saving from switching would seem to make any appeal to switch significantly more powerful. To provide details of the cheapest deal on the market a regulator would either require its own price comparison capability or would have to procure one from a commercial provider.

**Advantages:**
- Including credible information about potential monetary savings is likely to increase the potential of communications to boost switching.
- It guarantees that consumers will be told the best deal on the market regardless of the other communications they receive.
- It could provide a ‘whole of market’ benchmark even after the ‘whole of market’ requirements are removed from commercial PCWs.
- By highlighting the benefits of shopping around/search it may encourage consumers to engage in this behaviour and/or use PCWs more often.
- A market regulator may benefit from having a flow of PCW-like tariff information to help with its own market monitoring functions.

**Disadvantages:**
- A market regulator may need the capability to run a PCW itself.
- If a market regulator outsources the provision of PCW information, how will the market regulator monitor that the information being provided is correct? While a contract can be written, how will it be monitored and enforced? In other words, how are failures identified?
- Commercial PCWs may resist the provision of comparison information in communications unless they are providing the PCW function.
- If only mail communications are possible, what happens if a deal leaves the market/a better deal joins the market between when the communication is posted and a consumer choosing to switch?
- A market regulator might come under pressure to include in the ranking non-price factors fitting particular groups’ interests e.g. the environment/ethics.

**Issues:**
- If a market regulator provides a PCW (especially a whole of market PCW) service, there might be pressures from currently engaged consumers to access the service.
- How does the provision of free PCW-like information to a subset of consumers affect the wider PCW/intermediary market?
- How will the market regulator rank energy suppliers? By price alone?
- Suitable warnings need to be given if the ranking methodology is likely to deliver poor results to particular groups

(c) A basis for experiments

Description: A market regulator would utilise the database for randomised control trial experiments to assess interventions aimed at increasing the rate of switching and to gain knowledge regarding other socially important questions. To maximise the range of ideas explored and the quality of experiments an open process would be run for firms and other organisations, including academic institutions, to suggest experiments. The market regulator would make public its decisions regarding which experiments to pursue, the experiments that had been implemented and the results of these experiments. If the market regulator had limited bandwidth to conduct experiments, it could commission consultancies to perform the research although this would require appropriate monitoring and data sharing mechanisms.

Advantages:
- The market regulator retains greater control over the design of experiments and might be more ‘neutral’ in deciding what should be investigated.
- The market regulator can avoid ‘clashes’ between multiple experiments being run at the same time.
- Matches the recommendation made by the CMA
- The experiments may deliver insights relevant for regulators beyond the energy market.

Disadvantages:
- A market regulator may be limited in the number of experiments it can run at any one time thus limiting the pace of learning.
- Running robust experiments will probably require co-operation from incumbent firms in an activity (learning how to promote switching) which appears to directly conflict with their interests
- Supplier attempts to subvert/delay experiments will be difficult/impossible to prove due to asymmetric information between the market regulator and incumbent firms
- Properly planned experiments can take considerable time to implement and analyse e.g. over a year. There may be challenges in managing stakeholder expectations regarding the pace of change
- Pressures to publicise experiments before they have been run may interfere with their results and/or create expectations of positive outcomes/actions that may not be fulfilled

Issues:
- If lessons from the experiments imply benefits for disengaged consumers but costs for other consumers, how will the market regulator proceed?
- The market regulator will need a mechanism for assessing whether firms are cooperating with experiments and an enforcement approach to incentivise compliance.
- The market regulator needs a mechanism to gather ideas from external parties and select the most promising ideas for experiments
- What measure would be in place to ensure experiments adhere to robust academic standards?
- A ‘bogged’ experiment may be worse than no experiment, the market regulator may need to be prepared to walk away from experiments if circumstances mean their results are no longer robust
- The market regulator needs to be confident that it can communicate negative messages, e.g. it is very difficult to make people switch more, as well as positive ones

5. Personalised Support Services

Description: The provision of resource intensive support services to encourage switching and/or ease the financial burden of energy costs on households. The support may be provided face-to-face and or
over the phone and would probably involve repeated contact to maximise effectiveness. All forms of support would include a discussion of how to minimise a household’s energy bills. The resource intensive nature of the support would probably mean that it could only be provided to a subset of disengaged consumers deemed particularly worthy of additional support. In turn this would require an effective targeting mechanism to be in place and, if consumers were to be shown the cheapest supplier for their needs, access to a whole of market price comparison service. A key part of implementing a personalised support service would be the recruitment and training of staff to provide the personalised support.

Advantages:
- More likely than letters or cold calls to initiate behaviour change or switching
- Possible to fully understand an individual’s situation and tailor a solution which closely matches their needs
- Possible to learn in considerable detail about how different groups engage with the energy market and the barriers they face

Disadvantages:
- Very high cost. Do the benefits outweigh the costs? If they do, who will provide funding?
- High cost probably implies only a subsection of disengaged consumers will receive support
- Would a market regulator have expertise in providing personalised support?
- If a single consumer requires multiple contacts, management of the advice giving process may be complex.
- If the intervention activates some consumers, the average ‘stickiness’ of the remaining disengaged consumers will have increased so they might be charged higher prices
- A consumer engaging with the energy market involves an opportunity cost, the more consumers who engage/search/switch, the higher these costs.

Issues:
- Who will deliver the service? How difficult is it to recruit and train competent advisors?
- Assuming limited funds mean only a small subsection of disengaged consumers can be contacted, which consumers will receive the support?
- How do the advisors obtain the necessary information to give accurate advice? Is effective personalised support conditional on a ‘whole of market’ PCW existing?

(a) Providing advice on all household bills

Description: While a household might not be minimising the cost of their energy supply, there could be other bills where a household could receive a greater reduction in expenditure for a similar investment in time. Rather than just focusing on energy this option would involve identifying the household bills, regardless of sector, where there is the greatest potential for saving thereby maximising the welfare gain for households receiving support. While providing a wide ranging financial/bill review service may maximise the savings achieved, it is likely to be a significantly more complex and time intensive task than simply supporting switching between energy suppliers. This added complexity implies a larger resource requirement with greater training and technical support for the advisors providing the personalised support being required.

Advantages:
- There is no guarantee that switching energy supplier is the expenditure item that will save a consumer the most money, dealing with other bills may be more important
- The ability to offer a broad range of advice should maximise the benefit from any advice session
- There are spillover benefits to other sectors
Disadvantages:
- Is it appropriate for a market regulator to tackle general financial/consumer literacy problems?
- Can a full picture of a consumer’s financial commitments and utility expenditure be gained in a short advice session?
- To advise on a wide variety of topics advisors would seem to require a lot of training or a very comprehensive (costly?) computer support system

Issues:
- Is there a case for government to fund more services in this area given the cross-sector aspects of the issue?

(b) Energy Efficiency Investments

Description: Since households on default tariffs are expected to pay particularly high prices for energy they would appear to be an attractive group for the provision of energy efficiency advice through a personalised support mechanism. Supporting household energy efficiency investments would also help efforts to reduce fuel poverty and carbon emissions. The aim would be to reduce the quantity of energy demanded rather than the price of energy. Since many of the disengaged are in relatively weak economic positions it would be important to include funding for energy efficiency investments alongside the provision of advice.

Advantages:
- If disengaged consumers are being charged a high price for energy they are likely to have a particularly high benefit from energy efficiency improvements
- It may help to meet government aims regarding fuel poverty reductions
- It helps to reduce carbon dioxide emissions

Disadvantages:
- If the disengaged tend to be on lower incomes they are unlikely to have the spare financial resources available to purchase energy efficiency devices
- The rebound effect means that energy consumption reductions from energy efficiency investments may be smaller than first thought
- Tenants in private rented accommodation may be unable to give permission for energy efficiency improvements to occur
- The opportunities for additional value adding energy efficiency investments in social housing might be limited due to existing retrofit schemes
- Only a subset of disengaged consumers may be households where energy efficiency investments provide good returns. Identifying particular households falling into this subset could be difficult.
- The general take up of energy efficiency measures, even where financial support has been provided, has been underwhelming
- Disengagement regarding switching suggests that the targeted households may be of an ‘innate’ type that has a low engagement rate with interventions i.e. the chances of low take-up rates are high
- A source of funds to pay for the energy efficiency upgrades would be required.
- Is there the risk of the scheme being ‘captured’ by those installing the energy efficiency measures?
- Economies of scale mean it is cheapest to retrofit multiple houses in a given geographical location, what if disengaged consumers are geographically dispersed?

Issues:
- Would all energy efficiency technologies be included in the scheme? If not, how would technologies be chosen?
- Does it make more sense to target energy efficiency investments/subsidies at landlords? The prospect of their property being upgraded for free or at a discount may be very attractive.

6. Targeted Price Regulation

**Description:** Having identified all the consumers who had remained on a default tariff for more than three years a targeted price cap could be introduced for these consumers. While the methodology for calculating the price cap would need to be determined it would seem sensible for it to include headroom above what is judged to be the ‘competitive price’. A sensible starting point for calculating the price cap might be the methodology used for the calculation of the PPM price cap. A key part of designing the regulation would be determining the criteria for a consumer to no longer be subject to the price cap. As a starting point it would seem sensible for a consumer that engages by switching to an alternative supplier or a fixed term tariff with their existing supplier to no longer be covered by the price cap. This would create an incentive for firms to move consumers off default tariffs and onto tariffs with clear renewal points and points to consider switching. However, a market regulator might need to put in place additional regulatory rules/principles to avoid gaming whereby consumers are encouraged to switch to tariffs that in the long-run end up above the level of the price cap. The targeted price cap would remain in place until it was demonstrated that the problem of consumer disengagement had been resolved and the price cap would be applied to all firms.

**Advantages:**
- Targeted price regulation seems acceptable given the PPM price cap
- The methodology for calculating the PPM price cap could provide a template for calculating a wider price cap
- Disengaged consumers are the consumers most likely to be failed by the market and they show some correlation with ‘vulnerable’ groups
- The database provides an ‘identifier’ making it operationally achievable to apply a price cap to a wider set of consumers beyond those with a PPM.
- A wider price cap may receive significant political support

**Advantage or Disadvantage:**
- A wider price cap might encourage full regulation of the entire retail energy market

**Disadvantages:**
- Is the PPM price cap methodology robust when applied to a wider set of consumers/for an indefinite period of time?
- The PPM price cap methodology includes ‘headroom’ so it only provides partial protection and may create a ‘false sense of security’
- Mixing competition and regulation is likely to be challenging e.g. the price cap might create a focal point supporting tacit collusion
- If a consumer only becomes subject to the price cap after three complete years of disengagement, it might encourage price increases for consumers who had been on a default tariff for less than three years
- If fixed costs are disproportionately allocated to disengaged consumers, a binding price cap could lead to an increase in the prices charged to other consumers
- That disengagement results in eligibility for a price cap seems to create an added incentive to become disengaged
- There might be operationally complex issues for firms regarding their charging systems if an individual consumer’s behaviour changes whether they are classified as disengaged and, hence, whether they are subject to the price cap
- Setting a price cap for disengaged consumers might be more challenging than for PPM consumers since disengaged consumers may be a more diverse group and have more varied costs to serve.
- It seems difficult to argue that the price cap would only be temporary: general consumer disengagement seems harder to solve than the technical issues which the CMA argues currently restrict competition in the PPM market.

**Issues:**
- Once classified as disengaged would a household always be eligible for a regulated tariff? If not, what would be the criteria for no longer being eligible?
- Would consumers who reach the ‘disengagement’ cut-off in the future be eligible for the regulated tariff? Or would only those who are currently disengaged be eligible?

### 7. Do Not Implement a Database

**Description:** If all the options above appear infeasible or have expected costs that exceed the expected benefits, the best remaining alternative might be not to implement a database. None of the implementation steps for a database would occur with no data being collected or transferred. Instead the scheme organiser would publish a clearly argued case setting out why implementing the CMA’s database remedy is not possible or is inadvisable. While a database itself would not be implemented, a market regulator could require the ongoing collection of data from energy firms relating to the number of their consumers who were on a default tariff for three years or more so that consumer disengagement could be monitored. In place of a database a market regulator might require additional actions by firms targeted at consumers on default tariffs to encourage these individuals to switch to cheaper tariffs.

**Advantages:**
- There is no risk of additional harm being caused by a new intervention
- It may be more honest than applying a remedy simply to give the appearance of action
- There are no new costs that the database organiser or other parties need to finance
- Interventions with the potential for strong distributional consequences might be more appropriately carried out by government

**Disadvantages:**
- There is no benefit to this action
- It goes against the recommendation of the CMA, implicitly it might be seen as a critique of the CMA’s decision
- It may require the database organiser to withstand considerable political/industry/consumer pressure.
- If the database organiser did nothing, the government may feel the need to step in and take action thereby undermining independent regulation in the energy market
- If the policy is left to ‘drift’ rather than there being a clear statement that nothing will be done, the lengthy uncertainty could be damaging to firms and their decision making

(a) **Relabel default tariffs**

**Description:** Relabel all default tariffs with an easily understood negative name that strongly indicates that remaining on the default tariff is ill-advised. The name would be chosen to maximise its emotional impact but would need to be carefully selected to remain truthful and avoid ridicule. For example, calling the default tariff an ‘emergency’ tariff appears ill advised as few people would consider being on an expensive energy tariff a true emergency when compared to other life events. A better title which is informative, truthful and potentially emotive is to relabel the default tariff the ‘expensive’
Alongside renaming the default tariff other regulatory rules or principles may be required so that firms are required to feature the negative name prominently in their customer communications.

**Advantages:**
- This appears a low cost intervention
- Certain words produce strong emotions that may trigger action

**Disadvantages:**
- A poorly chosen name e.g. ‘Emergency Tariff’ has the risk of ridicule thereby undermining the measure and the reputation of the policymaker/institution picking the name. Something like ‘Expensive Tariff’ seems more appropriate if the evidence is solid.
- Given the way tobacco firms react to restrictions on their branding, there might be legal challenges from firms
- Do the disengaged give sufficient attention to their bills or other energy communications for them to notice the name of the tariff?
- It may encourage more complex tariffs that avoid the negative ‘label’ but which have similar economic effects
- Unless a suitable principle based regulation is introduced there may be a continuous ‘cat and mouse’ game between a market regulator and firms over which tariffs receive the negative label.

**Issues:**
- Is there much evidence that name changes have a substantial impact on switching behaviour?
- What are the core identifiable characteristics of default tariffs that a market regulator could use to select the tariffs that receive a negative label?

**(b) Require additional efforts by firms to encourage engagement**

**Description:** Rather than targeting interventions specifically at those identified as disengaged a simpler set of regulatory interventions might involve just making incumbent firms perform additional activities to encourage engagement among all consumers on default tariffs. For example, there might be a requirement for additional communications explaining how to switch or pointing consumers in the direction of PCWs. Alternatively, a rule might be introduced requiring consumers to take a positive action once a year if they want to remain on the default tariff. Depending on the strength and costs of these required activities firms might be deterred from using evergreen default tariffs altogether. Regardless of the specific activities required, the market regulator would need to put in place a robust monitoring framework to ensure that firms were complying with the new requirements.

**Advantages:**
- Most of the costs would fall on firms
- The additional required activities could be informed by experiments
- Requiring additional activities from large firms may encourage new higher standards across the industry

**Disadvantages:**
- The market regulator would need to design, fund and run a robust monitoring and enforcement operation with meaningful penalties
- Just because firms will bear most of the costs does not mean the policy is sensible in terms of total benefits outweighing total costs. Firms may recoup the costs from consumers
- Incumbent firms are likely to take a ‘tick box’ approach since their incentives are to do the bare minimum as they are really aiming to retain disengaged consumers
- Will consumers be confused if their existing supplier undertakes activities which seem to encourage them to leave for another firm? Consumers may note this is not how firms usually/are supposed to behave.
- Can activities be designed that stimulate switching by a noticeable amount?
- Incumbent firms may alter their ‘marketing mix’ so that the required measures which encourage switching are offset by other changes that they make

Issues:
- What additional activities would a market regulator want firms to engage in?
Appendix B - Data Privacy

The following discussion of data privacy issues and a database is not designed to comment on any specific proposal from Ofgem or any other body regarding the CMA’s database recommendation, nor have we been asked to do so. Rather it is a think piece expressing our opinions as academics on issues that arise when the concept of a ‘disengaged consumer database’ is considered in a broad sense. This includes highlighting potential issues that may become relevant if the scope of any database increases at some point in the future. By definition this means that some of the comments are intentionally speculative in nature. We want to stress that in no way should our comments be taken to be legal advice in respect of any specific policy proposals.

The most important thing to understand about the privacy and data protection issues surrounding the establishment and use of a database is that there is a very significant amount of uncertainty. There is uncertainty about the legal regime that will be in force when a database comes into action, uncertainty about the way that the legal regime might be enforced and uncertainty about the public reaction to any scheme put forward. All these dimensions of uncertainty need to be taken into account when considering the form of scheme to adopt – or indeed whether to put forward a scheme at all.

B.1 Privacy and Data Protection

One thing that needs to be understood from the offset is that, though there is a considerable overlap, privacy and data protection are not the same. Data protection as a legal regime covers more than just privacy, and many privacy issues related to a disengaged consumer database are not addressed by data protection law. Both need to be considered here. Compliance with data protection law is of course crucial, and the Information Commissioner’s response to the CMA’s call needs to be taken very seriously.

Some of the key issues raised by the Commissioner are discussed below – but the Commissioner’s warning that ‘[c]onsumer trust and confidence are essential to ensuring a competitive market’\footnote{ICO response to CMA call, 18 November 2016, p1} is relevant not just to where the plan is in potential conflict with data protection law, but where it is likely to make customers feel that their privacy has been invaded, even if that privacy has been invaded in compliance with the law.

Moreover, as noted below, there is a strong, informed and effective section of civil society that works in the field of privacy, and if they feel that privacy issues are being misunderstood, underestimated or ignored, they have the potential to cause significant problems and even prevent the project from succeeding.

B.2 Data Protection Law

Data protection is currently governed by the Data Protection Act 1998 (“DPA”), the UK’s enactment of the EU Data Protection Directive (“DPD”). As noted below, the DPD is due to be replaced by a new ‘General Data Protection Regulation’ (“GDPR”) which was passed in 2016 and will come into effect in May 2018. Part of the uncertainty noted above is quite how the UK will deal with the GDPR after Brexit.
or during some currently unclear Brexit transition arrangement – but the basic principles of both the DPA/DPD and the GDPR are similar, and need to be considered directly. 98

There are a number of ways in which these apply to the proposed plan. One of the core principles of data protection is that of ‘purpose specification’. The second of eight Data Protection Principles states:

“Personal data shall be obtained only for one or more specified and lawful purposes, and shall not be further processed in any manner incompatible with that purpose or those purposes.” 99

By its nature and purpose, the database will contain personal data: the questions of whether the purposes for which it is going to be used in this database has been sufficiently specified, or are compatible with the purpose for which it was originally gathered are critical.

Data protection, as the ICO notes in their response to the CMA, also requires processing to be ‘fair and lawful’. The ‘fairness’ is perhaps the most misunderstood. A scheme may be lawful without being fair – as well as raising the trust issues noted above. Other aspects of data protection law will of course also be relevant – keeping data secure, for example, is something to be taken very seriously.

### B.3 Sensitive Personal Data

Another key concept in data protection law is that of ‘sensitive personal data’. This is defined in Section 2 of the DPA and includes amongst other things information as to a data subject’s physical or mental health or condition. 100 A disengaged consumer database could potentially come into this category – particularly if it is believed that there is a correlation between non-switching and vulnerability – although Ofgem expects to implement a database in a way which does not involve the use of sensitive personal data.

The sensitive personal data issue is not restricted to vulnerability issues. Data about someone’s ‘switching history’ can potentially be very sensitive not just in itself but in terms of what information can be derived from it. This becomes even more important when considered from a ‘big data’ perspective. For example, the fact that someone hasn’t switched providers in a number of years might correlate to anything from intelligence level to legal understanding, to vulnerability in many other ways. The point is that when aggregated with other data (including data that might be publicly available) it may be possible to derive other kinds of data.

When assessing the design of a database it is also worthwhile to allow for relevant future developments. As ‘Smart Meters’ become more common, it may be desirable for a database to include details of energy usage to ensure that those on the database are made appropriate and sufficiently attractive offers. 101 Were this to happen, the potential for the data to be regarded as sensitive personal data becomes greater. The kind of granular energy usage information that is gathered by Smart Meters can potentially be used to derive other highly sensitive data. It might be possible, for example, to work out which television programmes are being watched (by the timing of TV usage) and

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98 The Queen’s Speech included a new Data Protection Bill, but without any details. The assumption of most experts is that this will, in effect, duplicate much of what is in the GDPR, but until the bill is published it is not possible to be certain.


100 DPA Section 2(3)

101 If consumers could request such information to be on the database and some do so, then the lack of such information for other consumers on the database in itself provides users with valuable information. For example it would enable further segmentation of the market. For smart meter data not to enter the database one might potentially need to actually ban its presence.
from that derive interests, politics and religion. Timing of the use of kettles and cookers can indicate observance of religious fasts and so forth. All of this could count as ‘sensitive personal data’ in data protection terms, as well as being the sort of information that can be easily misused, and the kind of information that individuals might not want to be revealed. In response to such concerns, government has ensured that consumers have the right to determine, for instance, how suppliers can use smart meter information and whether it can be shared with other organisations.\textsuperscript{102}

Schedule 2 of the DPA sets out the conditions for the processing of personal data, while Schedule 3 sets out the additional conditions that apply to the processing of sensitive personal data. The thorny issue of consent (see the next sub-section) becomes even more significant – where consent is used as the justification for processing, for sensitive personal data the consent must be \textit{explicit}. Sensitive personal data also precludes the possibility of using ‘legitimate interests’ as the condition for processing data. The other conditions available under Schedule 3 are all difficult to justify for a database of this sort. Obtaining a better price for energy could not reasonably be considered to be a ‘vital interest’ of a data subject, for example. Ultimately, that means that consent would be paramount if sensitive personal data were to be used.

\subsection*{B.4 Acceptability, trust and opt-in/opt-out}

Whether or not a database uses sensitive personal data, public acceptability of the approach taken will be important to its success. Consent to the use of data may help acceptability - though the question of how the consent is gained is a key issue. A failure by a consumer to respond to a question is not \textit{explicit} consent. As many academics and regulators have noted, the current systems by which people scroll down pages on the web without reading them before clicking OK do not in any real sense mean that the consent is informed. That it is currently the general practice does not mean that it will remain acceptable as the regulatory environment develops – and a further note of caution should be raised in respect of the power of pressure groups and civil society to make it an issue, as they have done in the past. This may put pressure on those implementing any scheme to find a better way to gain genuine consent, and to ensure that this consent is properly informed.

Acceptability requires clarity in how the database will actually be used in practice. This includes making it clear who will be getting access to the database, how, and to what benefit. With the NHS’s ‘care.data’ scheme, through which data held by GPs was intended to be gathered into a central research database, this was one of the critical areas in which trust was lost, and ultimately led to the demise of that scheme. In the case of care.data, people were concerned that their information was going to be used to the profit of pharmaceutical companies and insurance companies, rather than to their own benefit or for what they considered to be appropriate ‘research’. Those behind care.data did little to calm those fears – and indeed evidence suggested that insurance companies in particular were already looking to gain from it.

There are some close parallels here: energy companies are viewed by many with levels of distrust similar to those for insurance and pharmaceutical companies, particularly in terms of exploiting and profiting from consumers. In order to both fulfil the legal requirement for informed, explicit consent and to gain the trust of the people concerned and relevant sections of civil society, first it must be ensured that the database is not used primarily to help energy companies to profit, and second that the mechanisms to ensure this is the case are explained in a simple, intelligible way.

\textsuperscript{102} See \url{http://www.energy-uk.org.uk/policy/smart-meters.html}. 
This will get a little more complex if one of the models that allows companies and others limited access to the database is chosen. It will be a delicate exercise to explain what is allowed to whom – but it is important that it is done correctly. The best way to make explaining easy is to have a simple and clear system in the first place, and one that does not stretch the limits of what might be acceptable to people.

### B.5 Anonymisation issues

One way in which the database might be used is for research – with the caveat that the data in the database be ‘anonymised’ before research is undertaken, so as to avoid privacy and data protection issues. Whilst this is in theory a good idea, it is important to note that ‘de-identified’ data – granular data about customers, for example, with names and addresses removed – is not really anonymised at all, and may be ‘re-identified’. Indeed, evidence suggests that even more carefully ‘anonymised’ data can often have that anonymisation reversed. There is considerable academic literature on the subject\(^\text{103}\), and the development of ‘big data’ techniques in recent years makes the point even starker. This means that care must be taken even when engaging in this kind of exercise, and ‘anonymisation’ should not be seen as a simple way to avoid dealing with data protection issues.

### B.5.1 Links to other data – and other uses

One possibility for a database is to link the data with other government data. For all the forms of data considered, there are both privacy and data protection issues. One underlying question as noted in section B.2 above is whether the purposes for which the data might be used through linking are compatible with those for which the data was gathered in the first place. Another is whether linking would expose the data subjects (or others) to additional risk – including the risk of ‘function creep’, through which the purposes for which data are used develop.

An example of this might be through linking to social security data. The positive and beneficial purpose for which this link might be made is to enable resources to be better targeted – but the system could also be used as a form of surveillance to ‘check’ whether people in receipt of benefits ‘deserve’ those benefits. This in turn could be used to limit or restrict benefits, and end up being a way to reduce expenditure rather than to help vulnerable people. This again feeds into the question of trust: if people think a system will be used to ‘spy’ on them, they are much less likely to trust the system, and hence likely to resist its implementation.

It could be a similar story with health data – and when health and social security data are linked together with energy use data, the possibilities of profiling for both good and bad reasons become greater. This is not a point that will be lost to privacy campaigners and others, as noted below. Links with other government data need to be treated with great care, particularly when the ‘big data’ possibilities of deriving additional data are considered.

This also brings in another key issue to be considered: the role of contractors and subcontractors in whatever systems might be contemplated. With the DWP, for example, the use of companies such as ATOS for Disability Living Allowance (DLA) and its successor system the Personal Independence Payment (PIP), as well as creating a good deal of controversy introduced another area of data vulnerability and potential for data misuse. Every new step in a process, every link in a chain, creates such a weakness – and again, the database organiser needs to be careful when involving such contractors in processes of this level of sensitivity.

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\(^{103}\) A good starting point is Ohm (2010).
B.6 Current and forthcoming legal issues

It is crucial to understand that the legal environment concerning the protection of personal data is in flux in a number of ways, adding considerable uncertainty to the creation of a database.

Firstly, as noted above, the whole European data protection regime has just undergone reform, with the new ‘General Data Protection Regulation’ (GDPR) having been passed in 2016 and due to come into force in May 2018. This is a comprehensive new piece of legislation, but a complex one, and the implications have not yet become fully clear. Indeed, interpretation of the GDPR will be a major subject for discussion over the next few years. The GDPR has two particular areas of emphasis that will matter in relation to a database:

1) An increased emphasis on consent
2) Specific mention of profiling

How these two changes will pan out in practice is still a matter for debate and discussion – but at the very least they will need to be taken more seriously than they have been in the past. In terms of consent, as noted above, even under existing data protection law this matters a great deal, particularly in relation to the sensitivity of the data. With the GDPR this will become even more stark as the emphasis on explicit consent will become more important. This, in turn, poses additional legal challenges to an opt-out system which, by its very nature, relies on implicit rather than explicit consent.

Profiling and ‘automated decision-making’ are also addressed directly in the GDPR: there is the potential for some uses of a database to come under this category. Quite how this will work in practice is far from clear: advice on the subject from the Article 29 Working Party, the body that advises the European Commission on data protection, is expected soon, but has not yet appeared. This, indeed, is part of the problem: there are many areas where the full impact and practical application of the GDPR remains distinctly uncertain. When the fact that the GDPR will enable much higher levels of fines and other forms of enforcement to apply is brought into the equation, the risks associated with data projects increase.

The timing of the reform matters: it will come into force before the UK leaves the EU. This means the UK will have to comply, at the very least for the short term. It is likely, however, that there will be compliance for longer than that: if there are to be data flows between the EU and the UK, the UK will have to satisfy the EU that it provides adequate data protection by GDPR standards. There have been mixed messages from government and the ICO about what will actually happen in these terms. Brexit itself, of course, has a large degree of inherent uncertainty.

To add to the uncertainty, the UK has a new Information Commissioner – Elizabeth Denham – who started in 2016. There are some indications that she will be both more ‘pro-privacy’ and more interventionist than her predecessors, which might introduce additional complexity. It was Elizabeth Denham who provided the response to the CMA’s call for representations.

B.7 Brexit and surveillance

As noted above, Brexit adds another dimension of uncertainty, and not just because of the GDPR. There is a further significant problem: UK surveillance law. Data transfers between the EU and the US have been subject to significant legal problems over the last few years. The overreach of US surveillance law meant that the old ‘Safe Harbour Agreement’ that allowed US corporations to transfer data between the US and the EU was struck down, and a new ‘privacy shield’ put in its place. That ‘privacy shield’ is likely to be legally challenged, and might well fall, particularly given some of the
suggestions made by Donald Trump since he became president. Indeed, his first Executive Order included a clause on privacy that might in itself fatally undermine the Privacy Shield.

When the UK has left the EU, there is a possibility that we will be in the same position as the US in relation to our data flows to and from the EU. The UK’s new surveillance law (the Investigatory Powers Act 2016, passed in November 2016) is in many ways even more intrusive than US law, so it may be very hard to get an agreement to allow data flows between the EU and the UK. This, given the current state of the GB energy market (and the number of foreign – in particular EU – entities involved, with EDF being French-owned, EoN and nPower German-owned, Scottish Power Spanish-owned among the ‘Big Six’) could cause even more problems. It is hoped that a resolution to these kinds of problems will be found, but so far they have been elusive and they add another level of uncertainty to the issue.

B.8 Civil Society, Pressure Groups and Trust

One final issue – the ‘privacy lobby’ is of increasing power and reach, and understands and uses social media in particular in ways that have great effect. The NHS ‘care.data’ project mentioned above was effectively scuppered because the privacy lobbyists accurately identified privacy issues and understood them far better than those in the NHS project did - including, for example, the question of ‘opt-in vs opt-out’ consent, which is taken very seriously by privacy campaigners. Those behind the project initially dismissed the campaigners as irrelevant, and their issues as trivial – they found out that they were wrong on all counts. The campaigners had expert knowledge, good legal advice and were very effective in their use of both the social media and the traditional media. They understood some of the critical issues – from the technical issues such as the fallibility of anonymisation (see section B.5 above) and the vulnerability of data to the nuances of consent and opt-in/opt-out and the detail of data protection law – better than the people behind the project. Care.data was eventually abandoned before it even got underway, and the project head left both the NHS and indeed the UK.

Any public data project needs to understand the privacy and data protection issues from the outset, and not dismiss the concerns as unimportant. Engaging with the issues – and the pressure groups – from the start is the best way to avoid a problem. As the ICO noted, consumer trust is fragile, and getting this wrong could cause a big mess. With care.data, the trust issue was critical,104 and a failure to fully understand this or engage with those who could help was part of the reason for the failure of the project as a whole.

As the ICO notes in some detail, the possibility that the data is used for direct marketing is a particular issue, as well as being something specifically addressed in data protection law. People don’t like direct marketing (one reason it has been legislated against specifically over the years). Modern marketing techniques can be particularly intrusive and disturbing, as they use data to target in ways that are not immediately obvious to the consumer. This is another factor that is directly relevant.

Further, energy companies are not considered particularly trustworthy – if anything, the opposite could be said to be the case. This must be borne in mind when designing a scheme, and is part of the reason that the ICO expressed a ‘strong preference’ for the market regulator assuming the role of a ‘trusted voice’105 in any process. This should be taken very seriously from a practical perspective as well as a legal one. If a database is to avoid the privacy pitfalls that could present themselves, the database organiser will need to be seen to be strong, clear and independent of both the companies and of other sectors of government that might be involved, and working clearly for the benefit of

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104 For a detailed discussion of care.data, see Oswald (2014).
105 ICO response to CMA call, 18 November 2016, p4
customers. Working with civil society of various kinds, from consumer groups to privacy advocacy groups, from the beginning, could be one of the keys to success.